SUPREME COURT, U. S.

71-1326

No. 71

In the Supreme Court of the United States

OCTOBER TERM, 1971

Supreme Court, U. S.
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MICHAEL RODAK, JR., CLERK

FEDERAL POWER COMMISSION, PETITIONER

v.

MOBIL OIL CORPORATION, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

ERWIN N. GRISWOLD,
Solicitor General,
SAMUEL HUNTINGTON,
Assistant to the Solicitor General,
Department of Justice,
Washington, D.C. 20530.

GORDON GOOCH,
General Counsel,
LEO E. FORQUER,
Solicitor,
J. RICHARD TIANO,
Deputy Solicitor,
FRANCIS J. GILMORE,
Attorney,
Federal Power Commission,
Washington, D.C. 20426.

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute involved	2
Statement	3
Reasons for granting the writ	8
Conclusion	14

CITATIONS

Cases:

Atlantic Refining Co. v. *Public Service Commission of New York (CATCO)*, 360 U.S. 378	11
California v. *Lo-Vaca Gathering Co.*, 379 U.S. 366	9, 11
Denman v. *J. M. Huber Corp.*, 251 F. Supp. 746, affirmed in part, reversed in part, 367 F. 2d 104	4, 12
Federal Power Commission v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498	6
Federal Power Commission v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1	11
Hugoton-Anadarko Area Rate Proceeding, 44 FPC 761, appeal pending, C.A. 9, No. 71-1036	8
Interstate Natural Gas Co., Inc., v. *Federal Power Commission*, 331 U.S. 682	13
Jersey Central Power & Light Co. v. *Federal Power Commission*, 319 U.S. 61	13

402-726—72——1

Cases—Continued

	Page
Permian Basin Area Rate Proceedings, 34 FPC 159, affirmed, 390 U.S. 747	12
Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672	11
Securities and Exchange Commission v. *Ralston Purina Co.*, 346 U.S. 119	13
Shell Oil Co. v. *Federal Power Commission*, 247 F. 2d 900, certiorari denied, 355 U.S. 930	11
United Gas Improvement Co. v. *Continental Oil Co. (Rayne Field)*, 381 U.S. 392	9, 10
United States v. *Bacto-Unidisk*, 394 U.S. 784	13
United States v. *Southwestern Cable Co.*, 392 U.S. 157	13

Statutes:

Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821–833, as amended, 15 U.S.C. 717–717w:	
Section 1(b), 15 U.S.C. 717(b)	2, 7, 8, 9, 13
Section 2(6), 15 U.S.C. 717a(6)	2, 3, 7, 8

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Solicitor General, on behalf of the Federal Power Commission, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (Mobil App. 15–40)[1] is not yet reported. The opinion of the Federal Power Commission (Mobil App. 41–80) is reported at 42 FPC 164. The opinion of the hearing examiner (Mobil App. 81–107) is reported at 42 FPC 187.

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[1] "Mobil App." references are to the appendices to Mobil Oil Corporation's petition for a writ of certiorari (No. 71-1169) from the judgment of the court of appeals in this case.

JURISDICTION

The judgment of the court of appeals (Mobil App. 11–13) was entered on December 17, 1971. On March 13, 1972, the Chief Justice extended the time for filing a petition for a writ of certiorari to April 15, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether the Federal Power Commission has authority under the National Gas Act, 15 U.S.C. 717, *et seq.*, to regulate royalty payments to landowners, or their successors or assigns, on natural gas sold for resale in interstate commerce.

STATUTE INVOLVED

Sections 1(b) and 2(6) of the Natural Gas Act, 15 U.S.C. 717(b) and 717a(6), provide:

Section 1(b):

> The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 2(6):

> "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.

STATEMENT

This case involves the Federal Power Commission's determination that it has jurisdiction under the Natural Gas Act, 15 U.S.C. 717, *et seq.*, to regulate royalty payments to landowners, or their successors or assigns, for their interests in natural gas sold for resale in interstate commerce. On review of the Commission's order, the court of appeals reversed. In addition to the instant petition, four other parties have petitioned this Court for review of the decision below.[2]

This controversy came to the Commission as a result of an action brought by certain royalty owners in a federal district court seeking royalty payments on the sale of natural gas in interstate commerce, under the terms of certain mineral leases granted to a producer of oil and natural gas.[3] The royalty owners contended

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[2] *Mobil Oil Corporation* v. *Carl E. Matzen, et al.*, No. 71-1169; *Amoco Production Company* v. *Leland C. Wuchter, et al.*, No. 71-1179; *Cities Service Oil Company* v. *Carl E. Matzen, et al.*, No. 71-1188; and *Shell Oil Company* v. *Carl E. Matzen, et al.*, No. 71-1191. We do not intend to file any responses to these petitions.

[3] In an oil and gas lease, the lessor's right to royalties is usually expressed in terms of a fraction of the proceeds from, or the market value of, the gas produced (Mobil App. 92). While the most common royalty fraction is one-eighth, in some instances it is larger (Mobil App. 91). Infrequently, the royalty

that, under the leases, their royalty payments should be calculated on the basis of the unregulated wellhead market price of natural gas, rather than on the basis of the rates filed by the producer with the Commission and collected from the interstate pipeline to which the gas was sold. The district court ruled in favor of the royalty owners, holding that the Commission has no jurisdiction over royalties; the court also held that under the leases royalties were to be paid on the basis of wellhead market price even if that value exceeded the just and reasonable rate determined by the Commission for interstate sales of natural gas from the leaseholds in question. *Denman* v. *J. M. Huber Corp.*, 251 F. Supp. 746 (N.D. Tex). On appeal, the Fifth Circuit agreed that the leases provided for the payment of royalties on the basis of market price, but ruled that the Commission had primary jurisdiction to decide whether it has jurisdiction over royalty owners and their interests in interstate sales of natural gas. 367 F.2d 104.

Following the Fifth Circuit's decision, the royalty owners in *Huber* petitioned the Commission for an order disclaiming jurisdiction over royalties. The producer in that case, J. M. Huber Corporation, opposed

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owner reserves the right to take natural gas in kind (*ibid.*). Under the lease, the royalty owner receives payment for his interest free of any of the costs of production, except taxes, and is protected by certain implied covenants with respect to the development of the lease and the marketing of the product (Mobil App. 92). The royalty owner is also permitted a depletion allowance under the federal income tax laws (R. 36). "R." references are to the printed appendix filed with the court below.

the petition (Mobil App. 85–86). Subsequently, Mobil Oil Corporation, another producer, filed a complaint (R. 312–323) seeking a Commission ruling that its royalty obligations are governed by its effective rates on file with the Commission. Mobil's complaint was filed in response to 283 individual suits and one class action brought against it in state courts in Kansas by royalty owners claiming royalties based on rates in excess of Mobil's effective rates on file with the Commission. Similar complaints were later filed with the Commission by Western Natural Gas Company (Mobil App. 86–87)[4] and Amoco Production Company (Mobil App. 87), who had also been sued in state courts by royalty owners.[5]

The Commission consolidated all the proceedings and set for hearing the question of its jurisdiction over payments made to royalty owners with respect to natural gas sold in interstate commerce and the question of how such jurisdiction, if it exists, should be implemented (R. 386–391).

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[4] The Commission, by order issued February 23, 1972, in Docket No. R167–310, approved a settlement between Western and its royalty owners. On March 2, 1972, the court of appeals permitted Western to withdraw its petition for review of the Commission's opinion in this case.

[5] The claims of some of these royalty owners are made under leases containing "market price" or "market value" royalty provisions, while others make the same contentions under leases containing "proceeds" royalty provisions (Mobil App. 92–93). These court proceedings have been stayed or otherwise held in abeyance, pending a final determination on the Commission's jurisdiction.

In its opinion (Mobil App. 41–80) the Commission affirmed the examiner's decision (Mobil App. 81–107) that royalty owners are engaged in sales of natural gas in interstate commerce and that, with respect to such sales, the royalty provisions in mineral leases are thus subject to the Commission's jurisdiction. In distinguishing the bonus[6] and the delay rental[7] provisions in such leases from the royalty provisions, the Commission explained (Mobil App. 53):

> The basic fact here is the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce. While that portion of the royalty contract on which the royalty owners focus, which results in payments prior to the production or discovery of natural gas or payments unconnected with the production of gas, may well be nonjurisdictional under the decision in [*Federal Power Commission* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498], the remaining portion of the arrangement, which results in payment to the royalty holder based on the production of natural gas for sale in interstate commerce, seems to us plainly to be jurisdictional. * * *

The Commission reasoned that since a royalty owner in executing a lease contracts to retain an "economic interest" in any subsequent interstate sales, he joins

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[6] A bonus is a cash payment by a producer to a lessor on the signing of a mineral lease, and has no direct relation to the ultimate quantity of natural gas actually produced from the leasehold.

[7] A delay rental is a payment made for the privilege of deferring drilling operations or production.

with other interest holders in such sales and thus is a seller of natural gas in interstate commerce. Accordingly, the Commission found that royalties constitute payment to royalty owners for their interest in the interstate sales (Mobil App. 54).[5] Since the sales are within the Commission's jurisdiction under Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b), the royalty owners are "natural gas companies" under Section 2(6) of the Act, 15 U.S.C. 717a(6), subject to the Commission's jurisdiction.

Having resolved the jurisdictional issue, the Commission further held (Mobil App. 56–57) that royalty rates for interstate sales are to be governed by either the rate provided for in the lease or the just and reasonable rate as determined by the Commission, whichever is lower. In addition, the Commission ruled that royalty owners are covered by the rate filings of producers and are not required to file separately with the Commission, even though their authorized royalties might be based on a rate higher than that which the producers, under their filings, are authorized to collect from the interstate pipelines to whom the gas is sold. Where the just and reasonable rate has not yet been determined by the Commission, royalties are to be governed by the producers' effective rates, subject to

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[5] Commissioners Carver and O'Connor dissented from the basic jurisdictional holding, but expressed the view that royalties under one of the leases in issue were within the Commission's jurisdiction since the gas covered by the lease was committed to the interstate market at the time the lease was executed (Mobil App. 60–80).

adjustment upon establishment of the just and reasonable rate.[9]

On petitions for review, the court of appeals (Mobil App. 15–40) reversed the Commission's order. The court rejected the conclusion that, because a royalty owner retains an economic interest in the gas sold in interstate commerce, he is a participant in a subsequent sale of natural gas in interstate commerce and thus is a "natural gas company" within the meaning of Section 2(6) of the Natural Gas Act, 15 U.S.C. 717a(6).

REASONS FOR GRANTING THE WRIT

The issue in this case is of fundamental importance to the administration of the Natural Gas Act, 15 U.S.C. 717, *et seq.* The decision below that royalty payments on natural gas sold for resale in interstate commerce are not subject to the Commission's jurisdiction conflicts in principle with prior decisions of this Court. Unless overturned, the decision will significantly inhibit the Commission from effectively regulating the rates at which such gas is sold.

1. Under Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b), the provisions of the Act apply to "the sale in interstate commerce of natural gas for

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[9] Subsequent to the Commission's opinion, the Commission, in Opinion No. 586, the *Hugoton-Anadarko Area Rate Proceeding*, 44 FPC 761, appeal pending *sub nom. Hugoton-Anadarko Area Rate Case (People of the State of California and the Public Utilities Commission of the State of California* v. *Federal Power Commission*), C.A. 9, No. 71-1036, determined the just and reasonable rates for sales of natural gas in the area in which all of the leases involved in the present case are located.

resale." In *United Gas Improvement Co.* v. *Continental Oil Co.* (the "*Rayne Field*" case), 381 U.S. 392, 400, this Court held that whether a given transaction constitutes a "sale" within the scope of Section 1(b) turns, not on technical concepts of local law,[10] but on the economic effect of the transaction judged in the light of the purposes of the Natural Gas Act. The economic effect of royalty provisions in mineral leases is to give royalty owners a continuing economic interest in subsequent sales of natural gas and thus to make such owners participants in the sales.

In concluding that a royalty owner is not a participant in a sale of natural gas, the court below found determinative the fact that under a standard mineral lease a royalty owner has no control over the incidents of such a sale (Mobil App. 29). But that fact does not diminish the continuing economic interest of the royalty owner in the sale. It is the economic realities and physical facts, rather than concepts of local law or contractual provisions, which are controlling for determining the applicability of the Natural Gas Act. See *Rayne Field, supra*; *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366.

In entering into an oil and gas lease, a royalty owner, in effect, appoints the lessee-producer as its agent. Under the lease, the producer is obligated to develop the leasehold and market any gas produced therefrom (Mobil App. 39, 92). If the royalty owner

[10] One basis of the court of appeals' reversal of the Commission's order in the present case was that the "royalty owner is not considered, * * * in conceptions of state law decisions, to be engaged in any 'sale' of gas" (footnote omitted) (Mobil App. 24).

had not entered into the lease, but had itself developed and sold in interstate commerce the natural gas underlying its property, it would clearly be subject to the Commission's jurisdiction.[11] The fact that the royalty owner designates another to develop and market the gas should not operate to bar Commission jurisdiction over the retained fractional interest of the royalty owner in the sale of the gas.

While it may be true, as the court below pointed out (Mobil App. 24), that a royalty owner has no title to the gas in which it has an interest, the absence of title under local law is not determinative. See *Rayne Field, supra*, 381 U.S. at 400. The transcending economic fact here is that the royalty owner has an interest in the production of gas which is sold for resale in interstate commerce. The only relevant difference from an economic viewpoint between the royalty owner's interest and the lessee-producer's interest is that the producer alone must bear the expenses incurred in discovering, producing and marketing the natural gas.

Finally, the fact that a royalty owner does not know at the time it enters into a mineral lease whether any natural gas produced will be sold in interstate, as opposed to intrastate, commerce is irrelevant to ultimate Commission jurisdiction. The actual disposition of the gas at the time of delivery is controlling for jurisdictional purposes, not the

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[11] The court below (Mobil App. 24, n. 10) noted that in the case of a royalty owner who took a share of the gas produced as royalty and sold it, its decision might be different.

knowledge or intention of the interest owners involved in the sale. Cf. *Shell Oil Co.* v. *Federa Power Commission*, 247 F. 2d 900 (C.A. 5), certiorari denied, 355 U.S. 930; *California* v. *Lo-Vaca Gathering Co.*, *supra*.

2. When Congress passed the Natural Gas Act, it "did not desire that an important aspect of this field be left unregulated," but intended instead to establish a comprehensive regulatory scheme. *Federal Power Commission* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 19. The Act "was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." *Atlantic Refining Co.* v. *Public Service Commission of New York* (*CATCO*), 360 U.S. 378, 388.

In *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, this Court ruled that the Commission has jurisdiction over the rates at which producers sell natural gas to pipelines for resale in interstate commerce. The Court recognized that the rates charged by producers "may have a direct and substantial effect on the price paid by ultimate consumers." 347 U.S. at 685. By its ruling, the Court strove to give the ultimate consumer the full and complete protection envisaged by Congress in enacting the Natural Gas Act. The decision below, by exempting the royalty owner's interest in such sales from Commission jurisdiction, threatens to remove a significant portion of the protection afforded consumers under the rationale of *Phillips*.

As the Fifth Circuit observed in *J. M. Huber Corp. v. Denman*, *supra*, 367 F. 2d at 116–117, provisions for royalties in mineral leases have a direct bearing on the establishment of area rates for interstate sales of natural gas by producers. In the *Permian Basin Area Rate Proceedings*, 34 FPC 159 (ultimately upheld in full by this Court, 390 U.S. 747), for example, the Commission acted on the assumption that royalties for interstate sales would be based on the ultimate area rate established. See 34 FPC at 192, 218. If royalty owners are now entitled to royalties based on the "market value" of natural gas as interpreted by state or federal courts or state regulatory authorities, the owners would in many instances receive compensation in excess of the royalty component allowed in the area rates determined by the Commission. The Commission would then be required either to let producers absorb the increased royalty obligations or to adjust area rates upward to accommodate the higher payments, thereby causing consumers to pay higher prices for natural gas. In short, the Commission's control over one significant component in the establishment of area rates would be lost.[12]

[12] The effect of the decision below is not significantly ameliorated by the fact that, in setting area rates, the Commission has authority to determine the reasonableness of costs incurred by producers even where such costs are not directly subject to Commission jurisdiction. In the absence of jurisdiction over

It is axiomatic that the Natural Gas Act, like other federal regulatory legislation, should be interpreted in furtherance of the Act's general purpose to protect consumers by effective regulation of natural gas wholesale rates. Cf. *Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U.S. 119; *United States* v. *Southwestern Cable Co.*, 392 U.S. 157; *United States* v. *Bacto-Unidisk*, 394 U.S. 784. The Commission, accordingly, concluded that a royalty owner's continuing economic interest in the sale of natural gas for resale to interstate pipelines makes him a participant in the sale and subjects his royalty interest to the Commission's jurisdiction under Section 1(b) of the Act, 15 U.S.C. 717(b). The contrary holding of the court below would significantly impair the Commission's ability to implement one of the Act's basic objectives, and therefore warrants review by this Court.

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royalty owners, royalty costs would be fixed prior to the incidence of federal control. Cf. *Jersey Central Power & Light Co.* v. *Federal Power Commission*, 319 U.S. 61, 71–72. The royalty payments would thus "become perpetuated in large part in fixed items of cost which must be covered by rates charged subsequent purchasers of the gas, including the ultimate consumer." *Interstate Natural Gas Co.* v. *Federal Power Commission*, 331 U.S. 682, 692–693.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.
SAMUEL HUNTINGTON,
Assistant to the Solicitor General.
GORDON GOOCH,
General Counsel,
LEO E. FORQUER,
Solicitor,
J. RICHARD TIANO,
Deputy Solicitor,
FRANCIS J. GILMORE,
Attorney,
Federal Power Commission.

APRIL 1972.

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Petitioner

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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MEMORANDUM OF RESPONDENTS SUPPORTING CERTIORARI

J. P. HAMMOND
WILLIAM H. EMERSON
P.O. Box 591
Tulsa, Oklahoma 74102

Counsel for Respondent Amoco Production Company

THOMAS G. JOHNSON
DAN A. BRUCE
One Shell Plaza
P.O. Box 2463
Houston, Texas 77001

Counsel for Respondent Shell Oil Company

ROBERT D. HAWORTH
P.O. Box 1774
Houston, Texas 77001

CARROLL L. GILLIAM
PHILIP R. EHRENKRANZ
1730 M Street, N.W.
Washington, D.C. 20036

Counsel for Respondent Mobil Oil Corporation

SAM RIGGS, JR.
GRAYDON D. LUTHEY
P.O. Box 300
Tulsa, Oklahoma 74102

Counsel for Respondent Cities Service Oil Company

April 26, 1972

WILSON - EPES PRINTING CO., INC. - RE 7-6002 - WASHINGTON, D. C. 20001

IN THE

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MEMORANDUM OF RESPONDENTS SUPPORTING CERTIORARI

Respondents Mobil Oil Corporation, Amoco Production Company, Cities Service Oil Company, and Shell Oil Company, all of whom individually have filed with this Court in Nos. 71-1169, 71-1179, 71-1188, and 71-1191, respectively, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case, pursuant to Rule 21(4) of the Rules of this Court, hereby urge that for the reasons set forth in such petitions, and in

the petition in this case, the petition for a writ of certiorari herein should be granted.

Respectfully submitted,

J. P. HAMMOND
WILLIAM H. EMERSON
P.O. Box 591
Tulsa, Oklahoma 74102

Counsel for Respondent
Amoco Production Company

THOMAS G. JOHNSON
DAN A. BRUCE
One Shell Plaza
P.O. Box 2463
Houston, Texas 77001

Counsel for Respondent
Shell Oil Company

April 26, 1972

ROBERT D. HAWORTH
P.O. Box 1774
Houston, Texas 77001

CARROLL L. GILLIAM
PHILIP R. EHRENKRANZ
1730 M Street, N.W.
Washington, D.C. 20036

Counsel for Respondent
Mobil Oil Corporation

SAM RIGGS, JR.
GRAYDON D. LUTHEY
P.O. Box 300
Tulsa, Oklahoma 74102

Counsel for Respondent
Cities Service Oil Company

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AMOCO PRODUCTION COMPANY, Petitioner, vs. LELAND C. WAECHTER, et. al., and THE LAND AND ROYALTY OWNERS OF LOUISIANA, Respondents.	No. 71-1179
CITIES SERVICE OIL CO., Petitioner, vs. CARL F. MATZEN, et al., Respondents.	No. 71-1188
SHELL OIL COMPANY, Petitioner, vs. CARL F. MATZEN, et al., Respondents.	No. 71-1191
FEDERAL POWER COMMISSION, Petitioners, vs. MOBIL OIL CORPORATION, et al., Respondents.	No. 71-1326

BRIEF IN OPPOSITION FOR RESPONDENTS CARL F. MATZEN, et. al. and LELAND C. WAECHTER, et. al.

Of Counsel:

FLEESON, GOOING, COULSON & KITCH
Sixteenth Floor — 125 N. Market
P. O. Box 997
Wichita, Kansas 67201

KRAMER, NORDLING & NORDLING
P. O. Box 969
Hugoton, Kansas 67951

WAYNE COULSON
DALE M. STUCKY
Sixteenth Floor — 125 N. Market
P. O. Box 997
Wichita, Kansas 67201

Attorneys for Respondents CARL F. MATZEN, et al.

"Letters" Inc., 702 South Emporia, Wichita, Kansas 67211 (316) 265-1691

TABLE OF CASES

Burnet v. Harmel, 287 U.S. 103, 107 (1932) 23

Butler v. Thompson, 92 U.S. 684 (1876) 30

Champlain Refining Co. v. Corporation Commission, 286 U.S. 210 (1932) 23

Continental Oil Co. v. FPC, 5 Cir., 370 F.2d 57 (1966) 34

F.P.C. v. Hope Natural Gas Co., 320 U.S. 591, 610 (1944) 24

F.P.C. v. Pan Am Petroleum Corp., 381 U.S. 762 (1965) 34

Federal Power Commission v. Panhandle Eastern Pipeline Company, 337 U.S. 498 (1949) 37

J. M. Huber Corp. v. Denman, 367 F.2d 104 (1966) 15

Mitzen v. Hugoton Production Company, 182 Kan. 456, 321 P.2d 576 (1958) 9

Panhandle Eastern Pipeline Co. v. Public Service Commission, 332 U.S. 508, 516 (1947) 22

United Gas Improvement Company v. Continental Oil Co., 381 U.S. 392 (1965) 34, 35

West v. Kansas Natural Gas Co., 221 U.S. 229, 255-256 (1910) 23

STATUTES

Natural Gas Act, as amended, 15 U.S.C. § 717, *et seq.*:

Section 1(a), 15 U.S.C. § 717(a)	23
Section 1(b), 15 U.S.C. § 717(b)	21, 22, 36
Section 2(6), 15 U.S.C. § 717a(6)	22, 23
Section 4(c), 15 U.S.C. § 717(c)	24, 26, 30, 32
Section 5, 15 U.S.C. § 717d	30
Section 7, 15 U.S.C. § 717f	30

SUBJECT INDEX

	Page
QUESTION PRESENTED	2
STATEMENT OF THE CASE	2
Description of Parties, Leases, Leasehold and Marketing Activities	3
Nature of Disputes between Lessor and Lessee and Resulting Litigation	9
Proceedings Before the F.P.C. and Review Thereof	14
REASONS FOR DENYING THE WRIT	17
ARGUMENT	18
This Case Involves No Unusual or Substantial Question of National Concern	18
The Decision Below Is Correct	21
There Is No Conflict Of Decisions	34
CONCLUSION	37

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FEDERAL POWER COMMISSION, Petitioners, vs. MOBIL OIL CORPORATION, et al., Respondents.	No. 71-1326

BRIEF IN OPPOSITION FOR RESPONDENTS CARL F. MATZEN, et. al. and LELAND C. WAECHTER, et. al.

Mobil Oil Corporation, Amoco Production Company and their supporting intervenors, Cities Service Oil Company and Shell Oil Company, have petitioned for certiorari. They were subsequently joined by the Federal Power Commission. These Respondents oppose.

QUESTION PRESENTED

The question is solely one of law, which can be fairly stated as follows:

Is a landowner a natural-gas company under the Natural Gas Act and are the amounts of monthly cash rental payments due to him under a mining lease subject to regulation by the Federal Power Commission if the lease permits lessee to use the leased premises for the purpose of manufacturing, mining, producing, saving and taking care of natural gas in commercial quantities thereon with an obligation to compute such cash rental payments as royalty, and the lessee, after such use, sells to others for its own account the natural gas so produced (owned solely by it as produced by it) for resale in interstate commerce?

STATEMENT OF THE CASE

The facts are undisputed.

Unfortunately, they are largely obscured in the petitions for certiorari. Because the Commission, made up of both lawyers and laymen, had no expertise as a body regarding the applicability of the facts to common law rules, it sought and received evidence regarding the state of the law, and the state of the law turned out to be undisputed.

The following statement therefore includes a summary of undisputed evidence regarding common law principles universally applicable governing the lessor-lessee

relationship involved. If this statement appears to be contrary to assertions made in the petitions, it is not because they are disputed but because of a certain ambivalence, only a few instances of which we will bother to point out as illustrative in footnotes as we go along.

Description of Parties, Leases, Leasehold and Marketing Activities

Each of these respondents, Carl F. Matzen, et al. and Leland C. Waechter, et al., is the owner of a tract of farm land in Western Kansas or a part thereof. The tracts vary in size, but the majority contain 160 acres. Each owner's interest is burdened by an oil and gas lease.

The leases vary in their language, but are conventional in form and include provisions of which the following can be described as fairly typical:

> "1. That lessor, for and in consideration of the sum of _____ Dollars ($_____), in hand paid, and of the covenants and agreements hereinafter contained to be performed by the *lessee* has this day granted and *leased* and hereby *grants leases* and *lets* unto the *lessee for the purpose of mining* and *operating* for and *producing* oil and gas, casinghead gasoline, laying pipe lines, building tanks, storing oil, building powers, stations, telephone lines and other structures thereon to produce, save, take care of and *manufacture all of such substances,* and for housing and boarding employees, . . ."
>
> "2. This lease shall remain in force for a term ending _____, and as long thereafter as oil, gas, casing-

head gas, casinghead gasoline, or any of them is produced."

* * *

"4. The lessee shall monthly pay lessor as royalty on gas marketed from each well where gas only is found, one-eighth (⅛) of the proceeds if sold at the well, or if marketed by lessee off the leased premises, then one-eighth (⅛) of its market value at the well . . . . Lessor shall have the privilege at his own risk and expense of using gas from any gas well on said land for stoves and inside lights in the principal swelling located on the leased premises by making his own connection thereto.

"Where gas from a well or wells, capable of producing gas only, is not sold or used for a period of one year, lessee shall pay or tender as royalty, an amount equal to the delay rental as provided in paragraph (5) hereof, payable annually at the end of each year during which such gas is not sold or used, and while said royalty is so paid or tendered this lease shall be held as a producing property under paragraph numbered two hereof."

"5. If operations for the drilling of a well for oil or gas on said land or for gas, on a consolidated leasehold estate of which this land is a part thereof, as contemplated in paragraph 9, are not commenced on or before _____ this lease shall terminate as to both parties unless the lessee shall on or before that date, pay or tender to the lessor, or to the lessor's credit in the _____ Bank at _____, or its successors, which bank and its successors are the

lessor's agent and shall continue as the depository of any and all sums payable under this lease, regardless of changes of ownership in said land or in the oil and gas, or in the rentals to accrue thereunder, the sum of _____ Dollars ($_____), which shall operate as rental and cover the privilege of deferring the commencement of drilling operations for a period of one year. In like manner and upon like payments or tenders, the commencement of drilling operations may be further deferred for like periods successively . . . ." (Ex. 4, R. 1152, Italics added)

Among the owners of such leases are petitioners Mobil Oil Corporation, Amoco Production Company and Cities Service Oil Company.

Leasehold operations were conducted on the leased premises by the respective lessees. Such activities eventually included natural gas production activities in the Kansas Hugoton Gas Field area through lessees' use of the land and wells drilled by them thereon.

The lessees were and are the first owners of all the natural gas they produce, as produced by them. In some instances the lessee had assigned leasehold interests to others, such as lease brokers or farmoutees. (For typical instruments see R. 1984-2010). Such lease assignments carried with them, or reserved in lessee, a fractional co-ownership interest in and to the natural gas as and when produced. Such ownership interest in natural gas is sometimes referred to as an overriding "royalty interest". (R. 1946)

The lessors themselves neither have nor retain nor obtain such ownership[1] or royalty interest[2] in the natural gas production. They have no natural gas or co-ownership interest therein to sell.[3] (Court of Appeals, Opinion, Shell Pet., p. 9a-11a).

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1 Mobil, on page 3 of its petition, states:

"Under state law, the various interests in the *total volume* delivered from a given well are classified principally as 'working' interests and as 'royalty' interests." As related to gas production involved in these cases, the statement is incorrect. We are confident this must have been unintentional. The interests mentioned could be more fairly described as interests in *leases*. They certainly cannot be described as interests in volumes of natural gas. Mobil then states that the working interest owner is the lessee and goes on to describe the lessor royalty interest in terms of a "percentage or fraction (e.g., 1/8)". From these references it might be inferred that the owners of the so-called working interest in the leases in question (the lessees) own a part of the volumes of natural gas delivered from a well, while the owners of the so-called royalty interest in the leases (the lessors) at some time own the other part of such volume. We are confident that Mobil must not have intended to create this impression, since it is admitted that this is not and has never been true. (A similar erroneous inference is created on pages 7 and 8 in Mobil's petition with reference to certificate and rate filings.)

2 Cities Service, Amoco and Cities in stating the question presented, and all petitioners elsewhere, refer to respondents' royalty interests *in natural gas*. They thus identify the interests of landowners with the overriding "royalty interests" of assignees from the lessee, above described. These royalty assignees of lessee, along with the lessee itself, are the only ones who have an ownership interest in the gas. They do not include the landowner-lessors. We feel confident that such use of words was not designed to confuse the Court. Nor is Mobil's inference in its footnote on page 6 of its petition, which could suggest that respondents are not lessors and part owners of the leased premises.

3 Mobil describes a "division order" as certifying lessors' "interest in natural gas delivered under rates schedules on file with the Federal Power Commission." (Mobil Pet., 7) Mobil surely did not intend to suggest that the landowner has any legal or equitable, possessory or non-possessory, interest in natural gas so to certify or that any such so-called "division order" refers to anything but cash amounts due as rental compensation to be made in accordance with the lease terms, and not as a division of volumes sold. (R. 1957-8)

The lessees and their assigns use and market the commodity solely on their own account under a variety of arrangements, eventually marketing the same in three states of matter — gaseous, liquid and solid. (R. 2049)

That part marketed (or used) by lessee in gaseous state not lost in transmission is sold by the lessee and its assigns to pipelines for resale in interstate commerce or is used by lessee as fuel in compressor stations, or is sold for other local purposes prior to delivery of the residue to the pipelines.

That portion marketed in liquid state (which is a part of a gaseous volume when produced) results from use of the natural gas by the lessee off the leased premises in removing valuable hydrocarbons which become liquefied (such as propanes, butanes and natural gasolines), which are then marketed by lessee off the leased premises, with only the residue gas remaining being delivered in gaseous state to pipeline companies. (R. 2030, 2040-2042)

The part marketed in solid state results from another use by lessee or an affiliate of the natural gas off the leased premises. That part is sold as carbon black, a residual of the combustion of the natural gas in facilities built for that purpose, marketed off the leased premises. (R. 2049)

All leasehold and marketing activities are carried out by the lessee and its assigns on their own account without any participation by the lessor. Lessor had no

"say" and no right to have a "say" regarding marketing. He had no role to play and played no role. His only relevant activity was signing the lease which gives him no rights regarding marketing (R. 1152, 1153). If he was curious, he tried to find out, if he could, what was going on, on his own land, and what was happening to the natural gas after production. (Much of such information is learned after a suit is filed.)

The lease typically gives lessee the privilege of using gas free of charge from any gas well in the principal dwelling house on the particular leased premises. If landowner-lessor wants to use the gas for any other purpose, such as for fuel to power irrigation pumps on the very leased premises, he is in the position of a complete stranger, — he must negotiate at arms-length, if he can, a separate purchase contract with his own lessee for the sale of the natural gas to him.

The lessee is obligated under the particular leases in question to pay the monthly rental computed as royalty, in *cash* and *not in kind*. Such payments are in amounts based on the amount of production each month. They are further related to a value factor described by use of words such as "market value", "market price", "wellhead value", "proceeds", etc.[4] Distinctions are made based on the various places and methods of marketing or uses to which the lessee puts the gas, the relevant value usually being on the leased premises and not at a place of delivery away

4 Shell pet., 35a-36a

therefrom after gathering, liquid extraction, etc.[5] (R. 1152, 1153)

As a result of the cash payment requirement and the various possible marketing conditions, the royalty is computed based upon *a percentage of the value* of the entire quantity commercially produced each month rather than upon the value of a *percentage of the production.*

Under the leases in question, the percentage is one-eighth. The leases refer to one-eighth of the appropriate value factor. None of them refer to one-eighth of the amount produced. (R. 1152, 1153)

Nature of Disputes Between Lessor and Lessee and Resulting Litigation

Disputes arose between the landowners and lease owners as to the amount of royalty payments which had become due each month by reason of production activities by lessee over a past period of months. They finally resulted in traditional lawsuits brought by landowner-lessors in Western Kansas in 1963 through 1965.

The litigation was of the same nature as litigation which has been going on for over a century between other landowner-lessors and their oil and gas lessees.

The nature and extent of such litigated disputes is revealed by the summary of the controversies with Amoco and Mobil which follows.

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5 Sometimes a proceeds-less-expense formula is used to arrive at a value on the leased premises when the gas is used and marketed off the leased premises in both liquid and gaseous state. See, for example, *Matzen v. Hugoton Production Company,* 182 Kan. 456, 321 P.2d 576 (1958).

Amoco as lessee beginning in 1954 made monthly payments amounting to .9375 cents per Mcf of the gas produced up to 1.5 cents per Mcf including 1.34 cents and 1.375 cents, plus in many instances (and in those instances with respect to each varying figure above mentioned) small additional payments by reason of an incremental value on the leased premises of liquefiable hydrocarbon content marketed by it off the leased premises through its own use of the produced gas (R. 2023-2026, 2030, 2053)[6] Amoco had, part of the time, computed its base payments through the use of a uniform per Mcf figure and all of the rest of the time by using varying per Mcf figures during each month, depending on whether the part of the natural gas sold in gaseous state was sold by it or was sold by its farmoutees (co-owners of the gas with it by reason of assignment of working interests in the leases) with the figures varying part of the time within the limits above mentioned depending upon which of its co-owners sold such produced gas and upon their proportionate ownership. (R. 2022-2030)

In 1963 Amoco began to withhold from the landowners' monthly compensation so variously computed by it as currently due, amounts it claimed it had overpaid during monthly periods nine years before that time. (R. 2022-24)

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6 All amounts are stated in the section based on values of per thousand cubic feet (Mcf) of all gas produced, at a pressure of 14.65 pounds per square inch absolute, with equivalent values stated where measurement is on another pressure basis.

The landowners asserted claims for additional amounts by reason of production after June of 1961 only, claiming that Amoco was obligated as primary and base lessee to assure monthly rental payments after that time based on a uniform value on the leased premises of 1.8125 cents per Mcf of all gas produced (regardless of such differing percentages of ownership in others), in addition to the incremental value by reason of the liquefiable hydrocarbon content separately marketed off the leased premises. They also resisted Amoco's affirmative claims of right of offset for alleged overpayments made during past months. (R. 2040-1)

Mobil, with respect to one group of leases, beginning in 1954 paid royalties amounting to 1.375 cents per Mcf produced, later reduced to a little over one-half of a cent per Mcf then increased to something below one cent per Mcf and later further increased to 1.375 cents per Mcf. In the latter part of 1965 Mobil first began to pay small additional incremental amounts by reason of the enhanced wellhead value of all of the gas produced by reason of its liquefiable hydrocarbon content separated and marketed by it off the leased premises. (R. 2039, 2024, 2040)

Additional adjustments in past payments were also made after the landowners filed suit when it was discovered that, notwithstanding the removal of liquids, shrinkage and fuel used in plants, Mobil had been selling more residue gas than the monthly amounts it had theretofore reported that it was producing. (R. 2041)

In December of 1964 it began withholding from current monthly payments, computed as above stated, amounts it claimed it had overpaid in months ten years before that time. (R. 2040)

The landowners claimed that Mobil was contractually obligated in recent years to make monthly payments amounting to about two cents per Mcf by reason of its production of all gas whether marketed by Mobil in gaseous or liquid state, compared with Mobil's claims that it was obligated over the period involved to make payments amounting to a little over 1.375 cents per Mcf produced in addition to varying small incremental monthly amounts by reason of the value on the leased premises of the liquefiable content removed and marketed by it through its use of the gas off the leased premises. (A. 2040-1, 2048)

With respect to a second group of leases, beginning in 1954 Mobil made payments amounting to 1.375 cents per Mcf with a reduction in 1957 to less than a penny. After suit was filed against it, it tendered a retroactive payment into court of additional amounts designed to make total payments amounting to 2.093 cents per Mcf for one period, down to 1.375 cents per Mcf for a later period, back up to 2.093 cents per Mcf for a still later period, and back down to 1.375 cents per Mcf. (R. 2045)

From the amount otherwise due under this retroactive adjustment, it deducted sums which it claimed to be due to it for alleged overpayments made for months many years before, when it was making payments amounting to 1.375 cents per Mcf, thus unilaterally recovering everything it

had paid except that amounting to less than a cent per Mcf. (R. 2045-6)

As to a third group of leases, Mobil made royalty payments amounting to 1.375 cents per Mcf produced for a period of time and then reduced payments so that they would amount to less than a penny per Mcf produced. (R. 2049) After suit was filed and in March of 1965 it tendered into court a purported retroactive accounting for additional royalties. The basis of payment for the adjustments was such as to result in total payments amounting to 1.875 cents for one period, decreased to 1.375 cents for a later period, increased back up to 1.875 cents for a still later period, and decreased back down to 1.357 cents thereafter, with Mobil withholding, in connection with such tender, amounts claimed due to it for earlier months. (R. 2049, 2047)

As to the second group of Mobil leases, landowners claimed that since December 1, 1958, they had been entitled to payments amounting to 2.093 cents per Mcf. produced and as to the third group of Mobil leases that they had been entitled to payments amounting to 1.875 cents per Mcf. produced, in both instances resisting Mobil's claims of a right of offset as to overpayments allegedly made during many months before that. (R. 2043-2049)

In summary, leases claimed that monthly royalties should be paid at figures since 1954 amounting to about a half cent per Mcf. produced to over two cents during later periods, with the landowners claiming that payments

amounting to a little over two cents per Mcf. should have been made consistently during later months.

The lessees engaged in motion practice, vigorously asserting what appeared to be every possible traditional defense. Landowners began filing individual suits. Because of the relatively small amounts for each landowner as compared with the great array of legal, technical and expert resources available to these major oil companies (a full allowable for one well is based upon 640 acres), groups of landowners attempted to change their actions into class actions and began filing class actions in the first instance. This was resisted by lessees and no class orders were or ever have been entered in the cases. (For representative state court pleadings, see R. 2021-2050, 1545, 2052, 2064, 2124, 2130, 2137, 2145, 2155, 2157, 2159, 2170, 2181, 2183, 2185, 2189, 1544-1559, 1561-1563, 1567-1571, 1151, 1154, 1855-1863)

Proceedings Before the F.P.C. and Review Thereof

Before any determination as to any substantive issue could be made, lessees seized upon an entirely new strategm. In 1967, Mobil and Amoco suddenly brought complaint proceedings against the landowners before the Federal Power Commission and Cities Service intervened. Each complaint was brought by a lessee against all of the landowners with whom it had such a dispute. In such complaints the lessees claimed, for the first time, that the respondents were natural-gas companies under the Natural Gas Act and that the amount of such monthly payments due to them

as lessors from the lessees were subject to direct regulation by the F.P.C. They also claimed that the landowners were violating the Natural Gas Act in seeking traditional judicial remedies to recover the contractual monthly amounts alleged to be owing to them under the leases.

The state court judicial proceedings were then stayed by federal court order at the instance of lessees and the landowners were required to go to the nation's capital, where they were introduced for the first time to the strange and baffling mysteries of expensive and lengthy administrative proceedings before the Federal Power Commission.

The respondents had theretofore been complete strangers to Commission regulation. They had never been parties to any proceedings before the Commission. They had not made or been required or notified to make any filings or appearances of any kind before the Commission.

The Commission was equally unfamiliar with landowners and leases. It had never considered disputes between such lessors and lessees. The Commission had no expertise as a body in this area, being unfamiliar with the lessor-lessee relationship. It affirmatively requested and received evidence as to the legal nature of the oil and gas leases and their economic consequences, above described.

The complaint proceedings were consolidated with somewhat similar proceedings previously filed by others,[7] and a divided Commission, by a 3-2 majority, found and held in the order on review[8] that the landowners were

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7 Resulting from the case of *J. M. Huber Corp. v. Denman*, 367 F.2d 104 (1966), Shell pet., 88a

8 Shell pet., 27a-40a

natural-gas companies, that the lease provisions requiring such periodic royalty payments constitute "sales" for resale in interstate commerce under the Natural Gas Act, and provided for implementation of its asserted jurisdiction in an attempt to regulate the amount of such payments retroactively to 1954.[9]

In its opinion, the Commission isolated out of the integrated lease that single portion containing the particular royalty formula.[10] It then isolated out of the royalty formula the particular words referring to the value of the gas, described by it as "proceeds", "market value", "market price", "wellhead value", etc.[11]. It held it had jurisdiction over such isolated words for the reason that they resulted in a payment "based upon the production of natural gas in interstate commerce."[12] It found the "basic fact" to be "the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce."[13] It held that whether "under private law"[14] the lessors ever had a legal or equitable, possessory or non-possessory, interest in such commodity first owned and sold by lessee and its assigns was not determinative.

It thus justified its departure from long established law on the basis of its description of such lease rental provision as an arrangement under which the lessor "retained" an *economic interest* in interstate sales sufficient

9 Shell pet., 39a-40a
10 Shell pet., 35a
11 Shell pet. 35a-36a
12 Shell pet., 36a
13 Shell pet., 34a
14 Shell pet., 35a

to describe that particular lease rental transaction as a "sale".

Various judicial review proceedings instituted by both sides were consolidated in the United States Court of Appeals for the District of Columbia Circuit. That Court, in a carefully reasoned unanimous decision[15] reversed on the grounds that neither the statutory language nor congressional intent justified such an attempt to extend the jurisdiction of the Commission.

REASONS FOR DENYING THE WRITS

This case involves only private contract disputes between landowners and their major oil company lessees. The lessees seek to avoid paying rent they agreed to pay many years ago. They conceived of the Commission's legitimate concern for the ultimate consumer as a possible instrumentality to achieve their purpose of enhancing their own profits. They convinced a majority of a sharply divided Commission that a century of real estate law could be obliterated by turning a rental transaction into a sale of a commodity on the theory that Congress in 1938 sought to protect the consumers from being exploited by farmers.

Some added scheme was necessary also to create additionally, out of thin air, a regulated "rate" for the pretended "sale". They therefore suggested that the Commission accept a loan for this purpose of their own service rate filings covering a different "sale" (an actual one) of natural gas made by them and their co-owners to

15 Shell pet., 1a-26a

others. The result was an attempt to make the landowners the only regulated persons in the history of our nation whose "rates" would be regulated, not by any examination of the economic impact upon them of the regulation, but solely by reference to the expenses, profits, investments, facilities, contracts, risks, tariffs, costs and allowed returns of other persons engaged in a completely different business. The sought-for order, in effect, ignored all of the provisions of the Natural Gas Act, except the word "sale", and all rules and regulations of the Commission thereunder.

But this flagrant attempt to misuse administrative regulation has not survived judicial scrutiny. The result reached by the Court of Appeals is so obviously correct that this Court should not be burdened with its consideration. The result could only be further delay with many more landowners joining the many who have already died since the state court suits were filed.

ARGUMENT

This Case Involves No Unusual or Substantial Question of National Concern

This case involves private contract disputes. Recovery by landowners of any additional royalty would affect the companies' stockholders only. The first sale in interstate commerce was and is already 100% regulated as to 100% of the natural gas sold in interstate commerce, with no gap in regulation. F.P.C. jurisdiction is complete, the rates are fixed and the consumers protected.

The lease rental payments to landowners fall in the same category as rental payments on the companies' offices, wages paid to executives and drilling crews, and all other payments made by the lessees in connection with the production of natural gas. All of such costs result from agreements between the lessee and unregulated third-parties.

The Commission's theory of "economic benefit" to the lessor applies equally to all persons who derive economic benefit by being paid for goods or services furnished to them by lessees by reason of and in connection with the existence of its gas production activities.

In each instance a bargain is struck between the lessee and the person furnishing the land rented, the goods supplied or the services performed. That bargain is allowed to govern subject to the power of the Commission, in fixing producer rates, to determine the reasonableness of such costs not directly subject to its regulation.

The distinctions sought to be made between a situation where a flat sum is paid and one where it is based on a percentage is spurious.

In entering into rental agreements, the rental is always based upon what the parties feel is the use-value of the land. In the case of mining leases, that value is difficult to provide for and to measure when provided for. This means that, unlike similar provisions in other percentage leases based solely on net income, profits, etc.,

the mathematical formula in the gas lease requires the use of percentage factors relating to values not necessarily reflected by direct figures on lessee's books of account.

This case is here only because such use-value was disputed under the variety of marketing arrangements above described, the lessees unilaterally made judgment decisions as to what values they would use from time to time in computing and tendering payments — they are not billed by the lessors — litigation resulted regarding the proper amount of rental payments, and the lessors committed *lese majesty* against lessees in attempting to unite and use a judicial class action remedy hopefully available in recent years.

The existence of lawsuits resulting from such traditional disputes is of no more legal significance in the light of the Natural Gas Act than any other dispute involving expenditures of a lessee-producer.

This case does not present anything of national significance more than would be presented by any other dispute which the lessee would have concerning the amount owed by it to third-parties who furnish the resources which enable it to carry on its natural gas production activities.

These companies obviously paid landowner-lessors as little as they thought they could get by with. When challenged, they joined together in massively resisting the effort to get them to pay their debts. And they coercively

suggest that the recent possibility of landowners' use of class actions justifies transforming landowners into proper subjects of administrative regulation, thus attempting to avoid defenses for judicial determination. A more straightforward approach would be to frankly attempt explicitly to exempt major oil companies from the judicial rules providing for class actions.

As stated by Commissioner O'Conner in his dissent:

> ". . . I believe our jurisdiction of the lessee-producers is sufficient in and of itself to guarantee "an adequate supply at the lowest reasonable rates." The point I want to make very clear is that in my opinion the consumer will not suffer from a higher price by not regulating the amount the producer will pay to the royalty owner. This price paid by the producer to the royalty owners falls in the same category as the wages paid to his drilling crews, and the price he pays for the pipe he sinks into the ground." (Shell pet., 61a).

The Decision Below Is Correct

The opinion of the Court of Appeals is obviously carefully thought out, reaches the correct result and faithfully follows all previous decisions of this Court.

Section 1(b) of the Natural Gas Act states the full extent of its applicability:

> "The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial or any other use, and to natural-gas companies engaged in such transportation of sale,

but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas." 52 Stat. 821 (1938), 15 U.S.C. 717 (b)

Section 2(6) (Definitions) defines a "natural gas company" as:

"'Natural Gas Company' means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale." 52 Stat. 821 (1938), 15 U.S.C. 717a (6)

No more explicit statement of the scope of the Act could be made than that set forth by this Court in *Panhandle Eastern Pipeline Co. v. Public Service Commission*, 332 U.S. 508, 516 (1947):

"... Three things and three only Congress drew within its own regulatory power, delegated by the Act to its agent, the Federal Power Commission. These were: (1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale. ..."

No claim is made that respondents transport natural gas or are engaged in its transportation. Accordingly, respondents are subject to regulation only if they sell gas in interstate commerce for resale.

There is no indication anywhere that Congress did not have in mind the ordinary, usual and natural sense of the word "sale" when the Act was passed thirty-five years ago. And, as was pointed out by the Court of Appeals in

the decision below,[16] this would be particularly true because "sale" is not one of the terms for which Congress provided an express or supplemental definition in the portion of the Act, 15 U.S.C. Sec. 717a (Definitions), defining terms.

This Court, in cases before the enactment of the Natural Gas Act, described the production activities carried on by lessees as purely local mining and manufacturing operations carried on by use of the soil whereby a commodity which did not previously exist is created by lessee. *Champlain Refining Co. v. Corporation Commission*, 286 U.S. 210, 235 (1932); *West v. Kansas Natural Gas Co.*, 221 U.S. 229, 255-256 (1910); *Burnet v. Harmel*, 287 U.S. 103, 107 (1932). As the Court below pointed out,[17] this Court in the *Burnet* case observed the lack of incidents of a "sale" by a landowner-lessor under an oil and gas lease, both in technical terms and common understanding.

It is beyond dispute that courts have universally defined the payment of lessor royalty to landowner as payment for the use of his property in the nature of rental.

Nor is there anything else which shows the intent of Congress in 1938 to include such rental transactions within the meaning of the word "sales", or to include the fragmentated activities of the embattled dust-blown farmers of Western Kansas within the definition of a natural gas company. The 1938 Act was based upon Federal Trade Commission reports.[18] Certainly the thousands of farmers

16 Shell pet., 9a
17 Shell pet., 10a-11a
18 52 Stat. 821 (1938), 15 U.S.C. Sec. 717a

of this country were not included within the "handful of holding companies" who created the "specific evils" found by that Commission to exist and to which Congress addressed itself. See *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

The intent of Congress is also clearly demonstrated by the fact that all other language in the Act, in addition to the word "sale", is incomprehensible if sought to be applied to landowners and leases. As the Commission found out when it attempted to shoe-horn the landowners into the Act at the behest of the oil company lessees, there is no language in the Act that anybody (except an administrative body regulating to protect the regulated) can apply with a straight face to landowners or their leases. The language of the Act makes absolutely no sense when an attempt is made to apply it to landowners.

The Commission ran into the problem at the outset. Section 4(c) of the Act, 15 U.S.C. Sec. 717(c),[19] requires that every "natural gas company" file with the Commission within 60 days of the date of the Act in such form as the Commission may prescribe[20] and keep open in convenient

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19 Mobil App., 109

20 The Commission has never made any rules or regulations relating to landowners or leases. The producer regulations are effectively limited in language to apply only to lessee and his assigns (including over-riding royalty interest owners), *who are co-owners of the natural gas.* Lessees have filed lists of the names and percentage of ownership of everyone whose natural gas is being delivered under the rate filings made by lessees. They have covered 100% of the gas. They have not purported to name any landowner or cover any interest presumed to belong to him, nor has the Commission ever suggested they should. Nor does it now so suggest. Those same regulations require the filing of some document authorizing the operator to sell the gas belonging to the co-owners. Yet nobody has filed an oil and gas lease.

form and place for public inspection schedules showing all "rates and charges" for any jurisdictional sale and all "classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner may affect or relate to such rates, charges, classifications and services."

If the Act were applied to landowners, they would be required publicly to display their lease contracts. Presumably, tacking a lease contract on the wall paper in the front room next to the motto "God Bless Our Happy Home" would be sufficient for an indulgent Commission, although it might be more acceptable to tack it out of the weather in an outhouse or in a shed on the farm more accessible to the public.

Either realizing the absurdity of an open and admitted attempt to apply this crucial section of the Act to landowners and leases or in order to avoid being inundated by hundreds leases requiring the Commission to regulate all leasehold activities and the many inter-related lessor-lessee covenants resulting from the integrated instruments (and probably for both reasons), the Commission entered its ordering paragraph (B) fiat:

> "For regulatory purposes such sales are covered by the filings of the producer-operators and payments made by the producers to the royalty owners should be made as provided by the contractual provisions of each lease, except that in no event should the payment exceed the just and reasonable rates as fixed by the Commission under the Act."[21]

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21 Shell pet., 40a

The rate schedules filed by lessees as independent producers under the Act are contractual agreements made solely between them and a pipeline company, together with all agency authorizations in the case where the lessee acts as selling agent for non-signatory co-owners of the natural gas. The landowners are not parties, signatory or non-signatory, to these contracts or any such agency agreements and are not in any way legally bound by them.[22]

Assuming that the lease is an agreement for the purchase and sale of gas, the lessor is the *seller* and the lessee is the *buyer*.

In order to camouflage the inapplicability of Section 4 of the Act, the Commission had to conceal the fact that regulated rates must be contractual in the first instance, filed by *seller*. This was concealed by administrative fiat eliminating the statutory requirement of a seller filing under the pretense that the lessees' contracts with others, in which lessee is the *seller* is the identical contract under which he is a *buyer* from lessor.

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22 The argument that some "agency" might exist between lessors and lessees (see F.P.C. pet., 9) is specious. How could an agent agree to sell for a price other than agreed upon in the lease contract which is presumed to create the agency? We do not understand the reason for Amoco's reference to a claim of a fiduciary duty with respect to its gaining a higher price for gas (Amoco pet., 4) unless it also is an attempt to infer agency. The reference is obscure, but probably relates to the landowners' position, squarely contrary to that suggested by Amoco, that lessees could not possibly be considered acting as lessor's agent and that Amoco's and Mobil's rates could not possibly be considered as applying to landowners royalty payments in view of their practice of making price concessions in nation-wide settlements as to gas produced by them on Kansas premises in return for higher prices elsewhere in the interest of their stockholders.

As a further cover-up, the Commission found it necessary to ignore even a part of the royalty provisions of the lease relating to quantities produced. Otherwise, it would be readily apparent from the face of the order that the royalty payment was only a cash rental transaction.

This is clearly seen when it is remembered that rental payments are computed upon the entire produced volume, however marketed or used by lessee for its own purposes, and that, on the other hand, the lessee's gas sales contracts which it makes as seller of its own gas cover only the volumes ultimately delivered for resale in interstate commerce to pipeline companies.

The produced volumes used in computing the rental payments frequently are of greater value on a per Mcf. basis because those volumes contain, at that point, gaseous hydrocarbons which are later marketed by lessee to others in liquid state at equivalent per Mcf. prices that are greater than the per Mcf. prices for the volumes ultimately delivered by lessees to pipeline companies. So there is no identity of per Mcf. value either.

Assume a value on the leased premises of 16 cents per Mcf., including the value of liquefiable hydrocarbon content then in gaseous state. The landowners are to be paid based not on such value but on one-eighth of such value, or on the basis of 2 cents per Mcf. Assume, also, that the per Mcf. value of the residue gas finally delivered in interstate commerce by the lessee, after its use of it for other purposes, is 14 cents. If the rental payments are

considered as payments for the sale of gas, the per Mcf. price for the gas "sold" by lessor to lessee is one-eighth of that, or only 2 cents, while the sales price for gas sold by lessee to the pipeline company is 14 cents, or seven (not eight) times greater.

What the Commission did was to ignore that part of the rental computation which refers to the fact that the landowner is "paid", under a sales theory, for *all* of the gas produced and marketed or used. It pretended that the royalty is "paid" for only *one-eighth of the natural gas.*

The Commission disregarded this lack of identity of activities, quantities and values in stating that "the interests of the royalty owners are covered by the filings of producer-operators . . ."[23]

Under the Commission's order, it makes no difference what the percentage applied might be. If the percentage is 1/8th, the "price" due the landowner (assuming a value on the leased premises value of 12 cents) is 1.5 cents per Mcf.; if the percentage is 3/16th, the "price" is 2.25 cents per Mcf. Under the Commission's order, each is equally a fair and reasonable "rate" under the Natural Gas Act.

It is apparent from the above that, although the order was written so as to have general application, the order was effectively designed to protect only those lessees, petitioners here, who talked the Commission into entering it.

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23 Shell pet., 40a

But more to the point, the above demonstrates beyond a doubt that it takes a lot of verbal shenanigans coupled with unspoken and concealed legerdemain to try to make it appear that the Natural Gas Act can be adapted as a rent-control measure. If this seems to be a harsh criticism, Commissioner Carver said the same thing in different words. He described the order of his colleagues as a "bootstrap conclusion" which "taxes credulity to the breaking point"[24] made "with only the most general reference to statutory criteria and in reliance on precedents that have no direct bearing on the present issues."[25]

He also stated:[26]

> "In order to support a finding that royalty owners have participated in a sale of natural gas, it is essential that some specific operative act, some definite transaction, be identified as having the legally accepted characteristics of a sale.' * * *
>
> "We don't know the majority's theory in this respect, because the issue, and indeed the whole matter of how a sale occurs, is evaded by a forensic *tour de force.* The fact of a sale is declared, rather than demonstrated by any acceptable rationale. And we are told that technical concepts of law have no bearing since this Commission is not bound 'by Hornbook definitions or local decisions not applicable to the Natural Gas Act.' There is little doubt that this is an accepted benchmark in rule case law, * * *

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24 Shell pet., 46a
25 Shell pet., 45a
26 Shell pet., 47a-48a

"But we are not at liberty to enlarge that principle into an unrestricted license to snatch our own definitions out of the cosmos, hand-tailored to fit the case, any more than problems of construction can be swept away by denigrating reference to established legal concepts. The precise task at hand is to give meaning and effect to the 'sale for resale' criterion of jurisdiction and to measure the concept of a mineral lease against that standard. Absent some clear indication that Congress meant to abandon and deny accepted principles of property and contract law, they should be used as interpretive guideposts and aids to construction.

* * *"

This Court as early as 1871 considered and defined the word "sale" and quoted a learned author as saying, "If anyone of the ingredients be wanting, there is no sale." *Butler v. Thompson*, 92 U.S. 684 at 685 (1876). Here all ingredients are lacking.

Who is the seller? Under the Commission's order it is simply asserted that landowner is the seller. But the Commission does not consider him a seller under Section 7 of the Act requiring him to receive a certificate authorizing leasing of land by him. Nor is landowner considered a seller under Sections 4 and 5 of the Act assuring reasonable rates after giving consideration to the possible economic effect of regulation upon him as seller.

The cynicism with which the oil companies approach the entire matter is demonstrated by Mobil's reference to the royalty payments as a "windfall". (Mobil Pet.,

26) This is reminiscent of the following testimony before the F.P.C. in an area rate case drawn to the writer's attention by a friend:

> "Q. Do you consider that the bonuses and royalties paid by the producer to the lessor or landowner constitute economic rent to the landowner?
>
> "A. (Dr. Kahn) Yes.
>
> "Q. Does that mean there should be no compensation to the landowner?
>
> "A. Do you want my opinion or — it is a little hard to know how to answer this. In my judgment there should be *no compensation* to the landowner, or his compensation *should be taken away from him by the government.*" [Emphasis added]. (Transcript of Proceedings in South Louisiana Area Rate Proceedings, p. 13, 267)

How depriving landowners of this "windfall", the only compensation landowners receive by reason of *any* use of their land during production activities, will enhance the supply of natural gas (short of prior socialistic confiscation by Congress of interests in land) is nowhere explained by Mobil, although it and other petitioners pretend to be concerned about the supply of natural gas.

Who is the buyer? Under the order, the filings of the producers control. Under those filings, the only buyers are the pipelines. But jurisdiction is urged by reason of the royalty provisions of the lease, which, construed as a sales agreement, makes lessee the buyer. In reliance upon the lease agreements the lessees now seek, as buyers, retroactively to recover refunds and place limitations on

the amount they were contractually required to pay and did pay.

What is the contract of sale? Although Section 4 of the Act, as above stated, requires filing of all classifications, practices and regulations affecting rates and charges, together with all contracts which in any manner affect or relate to the same, the Commission and the proponents of what is essentially rent control are required by their "sales" theory to ignore all provisions of a fully integrated lease instrument except for the single word "value" or its equivalent.

What is the place of delivery? The leases do not, of course, provide for a place of delivery, since nothing is sold and no delivery is contemplated. There is no commodity to be delivered. All of the real, honest-to-goodness contracts for the first sale of 100% of the gas contain this ingredient.

The next question is, what is the price?

As pointed out above, lessees here have claimed that royalties should be computed in amounts resulting in payments ranging from less than a half-cent per Mcf. produced beginning in 1954 to over two cents during later periods, with the landowners claiming that payments should have been consistently made during later periods at a little over two cents per Mcf., and resist lessee's claims for refunds for alleged overpayments during earlier monthly periods.

The higher per Mcf. prices in the real gas purchase contracts in the range up to over sixteen cents are other

than the per Mcf. figures on which payments have been made to landowners, other than those which lessees claim they should have made, other than those which landowners claim, and other than those applicable on the leased premises on anybody's theory.

All of these anomolies result from trying to make a sale out of a rental transaction. The values of less than one-half to two cents per Mcf. on the leased premises constitute the agreed-upon use-value of the land while used for gas production purposes. They are paid as rental in the same manner as in other percentage leases. None of the indices of sale of a commodity are needed or present. These are the only rentals which lessor receives for all activities and uses during production activities. The use value of the land is continually reduced as production continues, resulting in the public policy of recognition of such deteriorating value through depletion allowance in the absence of other provisions for depreciation on unimproved land.

On the other hand, the higher values set forth in the contracts between the lessees and the pipeline companies are intended as payment for an actual sale of natural gas, with all indices of sale being present.

The Natural Gas Act obviously was not intended by Congress to be a rent-control measure to regulate rents under types of ordinary leases known to it to exist long before the Act was passed. It was designed to regulate "sales", a legal concept equally well known at the time, none of the ingredients of which we have present.

There Is No Conflict of Decisions

The *Rayne Field*,[27] *Ship Shoal*,[28] *and Bastian Bay*[29] cases, upon which petitioners rely, all admittedly involved actual and not pretended sales. All of the ingredients of sale above mentioned were admittedly present, including computed quantities but the lessees claimed that the economic effect of a conventional sale of gas could be avoided by making leases, rather than natural gas, the *subject* of an *admitted sale*. The court found that this was just a dodge. However viewed, the lessee was an admitted seller. The ownership of *all* of the natural gas came along with the lease sale. The pipeline became the owner of all of the gas, as it would under the conventional sale of natural gas. The indicia of sale including quantities under developed leases were identical whether the subject matter sold was described as a lease or as natural gas. Indeed, the cases are directly contrary to petitioners' position here, because they clearly show that all of the indicia of natural gas ownership produced under a lease is in the lease owner and not in the landowner.

Rayne Field certainly was not intended by this Court as a license to ignore traditional rules of contract law. In that case, the new arrangement was carefully drawn in such a way that it would result in virtually the same economic effect as traditional arrangements. Only the form was changed. On the other hand, the arrangement here is a traditional one — a rental arrangement that existed

27 *United Gas Improvement Company v. Continental Oil Co.*, 381 U.S. 392 (1965)
28 *Continental Oil Co. v. FPC*, 5 Cir., 370 F.2d 57 (1966)
29 *FPC v. Pan Am Petroleum Corp.*, 381 U.S. 762 (1965)

long before the Natural Gas Act. No change has been made with the view of changing the status of anyone or any transaction.

That royalties paid pursuant to an oil and gas lease have never been payments for the sale of gas results not from technical rules governing such transactions, but from the physical and economic facts surrounding the lease transaction. The proponents of F.P.C. jurisdiction in this case do not ignore technical rules of state law to give effect to an underlying economic reality. They turn *Rayne Field* upside down and, inventing a new rule of law, use *Rayne Field* to destroy the underlying economic reality. In *Rayne Field*, the lessees were told that the clever use of words would not prevail over the facts. But they are back at it again, attempting the same thing. By the use of clever words, they attempt to free themselves from the facts.

As stated by the Court of Appeals below:

> "When we came to an ordinary lease by the landowner to the producer there is neither a 'customary' sale in interstate commerce nor its equivalent in economic effect. Such a lease is a transaction that is itself customary and conventional, but one that precedes the 'conventional' sales in interstate commerce with which Congress was concerned, indeed even precedes the 'production and gathering' which § 1(b) visualized as preceding the sale in interstate commerce over which jurisdiction was being established.
>
> "Turning to the 'significant and determinative economic facts,' basically the significant fact for a sale

> in interstate commerce is interstate movement either by the seller, prior to or in connection with the sale, or by the purchaser, typically an interstate pipeline company, subsequent to or in connection with the sale. In the case of a typical oil and gas lease, there is no such interstate movement by either the transferor or transferee." (Shell pet., 14a-15a)

Shell relies on a theory that no sale exists but that the attempted expansion of jurisdiction might be justified on a burden-on-commerce theory.

Merely because royalty payments might affect the ultimate price to the consumer is not a ground for regulating them. Every expense of a natural gas company has that effect.

Numerous substantial items of cost are incurred by natural gas companies. Among other things, companies buy pipe, purchase leases, pay bonuses, hire well-servicing units, hire drilling equipment and pay for pipeline right-of-way. Each of these items represents a cost which could perhaps raise the price of gas to the consumer. As a result, if desirability of regulation alone were sufficient to create the power to regulate, the Commission should have power to regulate each of these items. But, of course, it has no such power. The provisions of 15 U.S.C. 717(b) define the limits of the Commission's power. Those limits have nothing to do with what is desirable. Instead, they depend upon whether the person sought to be regulated is engaged in the business of selling natural gas. Unless Congress has constitutionally delegated to that administrative agency

the power to regulate the particular transaction, the administrative agency has no such power. *Federal Power Commission v. Panhandle Eastern Pipeline Company*, 337 U.S. 498 (1949). Congress has not seen fit to expand the Commission's jurisdiction.

CONCLUSION

As we pointed out to the Court below, one is reminded of the medieval inn-keeper. If the guest was too long for the bed, his feet were chopped off; if too short, he was put on the rack and stretched. A few guests died that way, but they always fit the bed. A similar operation was performed here both on landowners and leases, all in an attempt to avoid judicial determination of questions of local import.

The careful decision of the Court of appeals is correct and faithful to all pronouncements of this Court. The petitions for writ of certiorari should be denied.

Respectfully submitted,

WAYNE COULSON
DALE M. STUCKY
By /s/ Dale M. Stucky
Attorney for Respondents
Carl F. Matzen, et al. and
Leland C. Waechter, et al.
Sixteenth Floor, 125 N. Market
P. O. Box 997
Wichita, Kansas 67201

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

MOBIL OIL CORPORATION, *Petitioner* *vs.* CARL F. MATZEN, et al., *Respondents*	No. 71-1169
AMOCO PRODUCTION COMPANY, *Petitioner* *vs.* LELAND C. WAECHTER, et al., *Respondents*	No. 71-1179
CITIES SERVICE OIL CO., *Petitioner* *vs.* CARL F. MATZEN, et al., *Respondents*	No. 71-1188
SHELL OIL COMPANY, *Petitioner* *vs.* CARL F. MATZEN, et al., *Respondents*	No. 71-1191
FEDERAL POWER COMMISSION, *Petitioner* *vs.* MOBIL OIL CORPORATION, et. al, *Respondents*	No. 71-1326

Brief in Opposition for Respondents William Harvey Denman Et Al

CECIL E. MUNN
1800 First National Building
Fort Worth, Texas 76102
Counsel for Respondents
William Harvey Denman, et al

Of Counsel:
Cantey, Hanger, Gooch, Cravens & Munn
1800 First National Building
Fort Worth, Texas 76102

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SUBJECT INDEX

Page

QUESTION PRESENTED 2

STATEMENT OF THE CASE 2

The Origin of the Litigation 3

REASONS FOR DENYING THE WRIT
(Summary of the Argument) 6

ARGUMENT 8

The Decision Below Is Sound 10

There Is No Conflict of Decisions 23

The Case Involves No Matter of Serious
National Concern 31

CONCLUSION 34

TABLE OF CITATIONS

Cases Page

Arkansas Natural Gas Co. v. Sartor, 78 F.2d 924 (5th Cir. 1935), cert.den. 296 U.S. 656 19

Burnet v. Harmel, 287 U.S. 103 (1932) 23

Chicago Corporation v. Wall, 156 Tex. 217, 293 S.W.2d 844 (1956) 19

Civil Aeronautics Board v. Delta Airlines, 367 U.S. 316 (1961) 22

Denman v. J. M. Huber Corporation, 251 F.Supp. 746 (N.D.Tex. 1964) 4

Federal Power Commission v. Pan American Petroleum Corp., 381 U.S. 762 (1965) 27

FPC v. Hope Natural Gas Company, 320 U.S. 591 (1944) 21

FPC v. Transcontinental Gas Pipe Line Corporation, 365 U.S. 1 (1961) 21

J. M. Huber Corporation v. Denman, 367 F.2d 104 (5th Cir. 1966) 4, 5, 9, 20, 24

LeCuno Oil Company v. Smith, 306 S.W.2d 190 (CCA Tex. 1957); writ den. n.r.e. (Tex.Sup.Ct.); 356 U.S. 974 (1958) 24, 25

Malat v. Riddell, 383 U.S. 569 (1966) 11

McNally v. Hill, 293 U.S. 131 (1934) 11

Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 341 U.S. 246 (1951) 27, 29

Old Colony RR v. Comm'r., 284 U.S. 552 (1932) 11

Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana, 332 U.S. 507 (1947) 6, 11, 21, 23, 26

Phillips Petroleum Company v. Bynum, 155 F.2d 196 (5th Cir. 1946) 19

Phillips Petroleum Company v. Federal Power Commission, 258 F.2d 906 (10th Cit. 1958) 29

TABLE OF CITATIONS (Continued)

Page

Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954) 3, 26

Southland Royalty Company v. PanAmerican Petroleum Corporation, 354 S.W.2d 184 (Tex. CCA 1962) 31

Southland Royalty Company v. PanAmerican Petroleum Corporation, 378 S.W.2d 50 (Tex.Sup.Ct. 1964) 30

United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965) 27

United Gas Pipe Line Co. v. Mobile Gas Service Corporation, 350 U.S. 332 (1956) 25, 26, 29

Union Producing Co. v. Pardue, 117 F.2d 225 (5th Cir. 1941) 19

Statutes

Natural Gas Act,
§ 1, 52 Stat. 821, 15 USC § 717(a) 20
§ 4(c), 52 Stat. 822, 15 USC 717c(c) 14

Miscellaneous

42 New York University Law Review 552 (1967) 20
45 Texas Law Review 765 (1967) 20

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Brief in Opposition for Respondents William Harvey Denman Et Al

Mobil Oil Corporation, Amoco Production Company and their supporting intervenors, Cities Service Oil Company and Shell Oil Company, have petitioned for certiorari. They were subsequently joined by the

Federal Power Commission. These respondents oppose. Because of the necessity to respond to five separate petitions, this brief is somewhat longer than we would have preferred.

QUESTION PRESENTED

The pivotal issue is solely one of law. It may be fairly stated as follows:

> Is a landowner who grants an oil and gas lease—on which the lessee subsequently discovers and produces natural gas which the lessee sells in interstate commerce for resale—a natural gas company so that royalties owing under the terms of the lease are subject to regulation by the Federal Power Commission?

The Court below answered that question, properly we believe, in the negative.

STATEMENT OF THE CASE

The basic factual context from which that question arises is helpfully uncomplicated.

A landowner grants an oil and gas lease. By authority of that conveyance the lessee drills wells which produce gas. The lessee sells that gas to an interstate pipeline. Pursuant to the lease obligations the lessee pays royalties to the landowner with respect to the lessee's gas production. The landowner reserves none of the gas production. He is not a party to the sale by the lessee nor does he necessarily agree that

the royalty is to be calculated on the basis of the lessee's price to the pipeline.[1]

The Origin of the Litigation

A short explanation of how these cases arose will place the controversy in needed perspective.

William Harvey Denman and other named trustees (the Burnett Trustees) are the owners of the Burnett Ranch in West Texas.[2] A controversy with J. M. Huber Corporation to whom they had granted an oil and gas lease is the genesis of the litigation now before this Court.

Since 1947 Huber had refused to honor its leasehold obligations as to the manner of computing royalties on natural gas production. It used first one excuse and then another for its refusal. After Huber's gas sales became subject to FPC regulation as a result of the 1954 decision in *Phillips*,[3] Huber added a new contention; namely, that such regulation entitled it to disregard the royalty obligations agreed to in its oil and gas lease and unilaterally to substitute a "proceeds" clause of the type which the Burnett Trustees

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[1] In many cases the landowner *does* agree to royalty calculated as a share of the lessee's sales proceeds. In those situations the problem envisioned by petitioners would not ordinarily arise. In very rare instances the lease may entitle a landowner to take, as royalty, a share of the gas in kind and sell it himself to a pipeline. In that event, the landowner would have made a sale to an interstate pipeline which of course would be jurisdictional. But no such situation is involved here and in the gas production industry it would be atypical.

[2] The beneficiaries of the trust are Texas Christian University and an attractive lady by the name of Anne Burnett Windfohr Tandy who lives but a few miles from Texas Christian University in Fort Worth, Texas.

[3] *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

had expressly refused to accept when the lease was granted in 1936.[4]

To resolve the dispute the Burnett Trustees filed suit in the United States District Court which considered and rejected Huber's contentions, including its argument that the FPC was the proper forum for the decision of such controversies.[5] On appeal the Fifth Circuit affirmed the rejection of all of Huber's substantive contentions. With respect to the argument that the lease controversy should proceed before the FPC, it declined judicial consideration of that jurisdictional issue until the Commission had first had a go at it. But the Court meticulously cautioned:

> "Lest we be misunderstood, we emphasize again that this analysis is merely to indicate why we conclude primary jurisdiction reference should be made, the Court all the while disclaims any purpose by what it has said or left unsaid, by its comments, express or implied, of declaring or intimating what its views are on the questions

[4] In *J. M. Huber Corporation v. Denman*, 367 F.2d 104, 109 (5th Cir. 1966), the Court pointedly observed:

> "Realizing as they had to, that the earlier and *rejected* draft of February 19, 1936, had an express 'net proceeds derived from the sale of gas' royalty clause which was in effect replaced by the 'market price' clause (note 4, supra) the Lessee-Producer's reported declarations made through its general counsel — a voice not only of management, but with an articulate awareness of the significance of legal terms — clearly put its construction of a market, not a proceeds, basis on this royalty clause. There were similar representations made to the FPC that under its gas leases 'it is obligated to pay royalty based on the market price at the well-head.'"

[5] *Denman v. J. M. Huber Corporation*, 251 F.Supp. 746 (N.D. Tex. 1964).

referred for initial decision by the FPC and the arguments pro and con."[6]

Following that mandate, the Burnett Trustees petitioned the Commission for an order disclaiming jurisdiction or, in the alternative and in the event the Commission should assert jurisdiction, an adjudication of the controversy.[7] At that point three other oil companies (Mobil, Western Natural[8], and Amoco) who had litigation with their lessors pending in Kansas petitioned the FPC to take jurisdiction of their cases. The Commission consolidated the three petitions, held hearings, received an examiner's recommendation and, by a 3-2 decision, asserted jurisdiction over the landowners and provided for its implementation. All parties appealed and the Court of Appeals for the District of Columbia reversed, unanimously holding that neither the statutory language nor the Congressional intent justifies such an extension of FPC jurisdiction.

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[6] *J. M. Huber Corporation v. Denman*, 367 F.2d 104, 120-121 (5th Cir. 1966).

[7] In obedience to the Fifth Circuit that procedure was followed notwithstanding this earlier telegraphic disclaimer from the FPC, set out at 367 F.2d 118 n. 49:

> ". . . Federal Power Commission does not fix royalty rates between a lessor and lessee nor does it have any procedure to adjudicate such a dispute."

[8] Western Natural subsequently settled all of its controversies, leaving only three complaining oil companies. See FPC petition p. 5 footnote 4.

REASONS FOR DENYING THE WRIT

(Summary of the Argument)

The carefully considered opinion of the Court of Appeals faithfully followed this Court's prior decisions. The case presents no unresolved issue of law. Nor, contrary to contentions of *some* of the petitioners, does it reduce FPC jurisdiction. Rather the decision below merely repudiates the efforts of a handful of major companies to *expand* that jurisdiction beyond its statutory limits as clearly defined by this Court:

> ". . . Three things and three only Congress drew within its own regulatory power, delegated by the [Natural Gas] Act to its agent, the Federal Power Commission. These were: (1) the *transportation* of natural gas in interstate commerce; (2) its *sale* in interstate commerce for resale; and (3) natural gas *companies* engaged in such transportation or sale."[9]

The decision below is sound. Neither by granting an oil and gas lease nor by accepting royalties on gas production from that lease does a landowner make a sale of natural gas—in law, in fact, or in substance. The term "sale" is used in the Act in a natural, not a distorted, sense. Typically the lessee sells 100% of the gas and the FPC in fact regulates that 100% sale. There is neither statutory basis nor economic need to extend such regulation behind the sale and to the royalty provisions or other terms of the lease from which the gas is produced.

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[9] *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 516 (1947). All emphasis in quotations is ours unless noted otherwise.

The theory expressed in the opinion of the Commission majority that a *part* of an oil and gas lease constitutes a jurisdictional sale—while at the same time recognizing that the lease itself is nonjurisdictional—created serious contradictions with the Act itself and was properly reversed by the court below.

The theory expressed in the Commission's petition for certiorari that the lessee is an agent of the landowner so that the sale by the lessee to the pipeline is in reality a sale by the landowner to the pipeline—besides contradicting the Commission's decision below—is clearly contrary to fact. The inescapable consequences of such a theory are self-refuting.

An extension of Commission jurisdiction over provisions of oil and gas leases would inject chaos into an already confused gas regulatory scheme. The legislative history of the Act negates any Congressional intention for FPC regulation of landowners who receive royalties on gas production.

Shell's argument to stretch jurisdiction to whatever affects interstate sales of gas is contrary to the statute itself and to this Court's prior decisions.

The decision below is consistent with this Court's prior decisions. The conflicts which petitioners urge were carefully considered by the court below and properly rejected. There is no rational basis for suggesting that traditional oil and gas lease forms, which were designed by oil companies and in use long before the Natural Gas Act was passed, were a landowners' subterfuge to avoid regulation under that Act.

The controversy is private in nature and of rather limited interest. Petitioners' efforts to find a novel issue of national concern are contrived and unavailing. Their exaggerations in that attempt are extreme and obvious.

ARGUMENT

This case presents one of many types of controversies which arise from time to time between landowners and their oil and gas lessees over the interpretation of oil and gas leases or with respect to operations on those leases. It is of a private nature and—notwithstanding the exaggerated protestations of the four major oil company petitioners—does not involve any crisis issue of monumental national import.

The anomalous effort of those few companies is to expand FPC jurisdiction into new and uncharted areas as a mandatory alternative to judicial resolution of issues which are typically judicial. The lack of candor of some of the petitioners is illustrated by the following comparison of assurances to the Court in two of the petitions for certiorari:

Mobil Petition	Shell Petition
". . . the Commission affirmed exercise of such jurisdiction for almost eighteen past years, but the Court of Appeals has reversed, . . ." (p. 3).	"The issue of jurisdiction over royalty claims is admittedly a new one for the Federal Power Commission as well as the Courts." (p. 15).
". . . a rate regulatory program already operative for almost eighteen years [has] been overturned with no remand to the agency." (p. 25).	

The truth is that the FPC never before has asserted jurisdiction over landowners except in two isolated instances of sales by them of gas reserved in kind.

The pretense that the Commission has heretofore established royalties payable under oil and gas leases is answered by the Commission itself. In an *amicus curiae* memorandum filed at the request of the Fifth Circuit in *J. M. Huber Corporation v. Denman*, 367 F.2d 104 (5th Cir. 1966), the Commission acknowledged that the argument was new to it:

> "Since the Commission has not had occasion to pass upon this important question as to the scope of its jurisdiction, we are not in a position to express any definitive position thereon at this time."[10]

Writing separately in that same Memorandum, Commissioner O'Connor was even more explicit:

> "Inquiring parties have, on numerous occasions, been given the information that gas royalty payments were outside the present regulatory responsibilities of the Commission, and it takes little imagination to conclude that such inaction indicates a lack of jurisdiction. . . . In the context of long understanding of Commission policy, the position is unavoidable that the Natural Gas Act has not up to the present been construed to encompass royalty-owners."[11]

After hearing from all parties the Court below put

[10]Page 2 of Memorandum for the Federal Power Commission Amicus Curiae, filed in *J. M. Huber Corporation v. Denman*, 367 F.2d 104 (5th Cir. 1966).

[11]Ibid. p. 23.

this matter in focus:

> "The Act was passed in 1938 and it has not heretofore been construed to apply to ordinary lessors. While inaction is not controlling on intent, the widespread assumption and acquiescence therein, including administrative and legislative acquiescence, extending over such a great period of time is not lightly to be brushed aside."[12]

The magnitude of the statutory stretch which petitioners seek to evoke from this Court is exposed by Amoco's description of "the instant case involving jurisdiction over many thousands of royalty interest owners" and its footnote reference to witnesses who "estimated the number to be hundreds of thousands in Louisiana alone".[13] The Congress has found no need to confer such regulatory jurisdiction. Nor should this Court do so.

The Decision Below Is Sound

Petitioners would support the extension of jurisdiction which they seek by urging that a landowner receiving royalties from a producer on gas production from land is a natural gas company who makes a "sale" of gas in interstate commerce for resale. The Court below, in a carefully reasoned opinion, correctly concluded that a landowner simply does not make a sale of gas:

> "To refer to the royalty owner as engaging in the sale is to depart from the common understanding of the words used, industry parlance,

[12]Shell pet., App. pp. 8a-9a.
[13]Amoco pet. 15.

> economic equivalent, or any other foundation hitherto considered a source for discerning Congressional intention."[14]

The three members of the Commission who urged the jurisdictional extension disapproved by the Court below never really came to grips with the decisive question, "Where is any *sale* by a landowner?" Commissioner Carver, dissenting, perceptively exposed this fatal deficiency in the reasoning of the FPC majority:

> "In order to support a finding that royalty owners have participated in a sale of natural gas, it is essential that some specific operative act, some definite transaction, be identified as having the legally accepted characteristics of a 'sale' . . . We don't know the majority's theory in this respect, because the issue, and indeed the whole matter of how a sale occurs, is evaded by a forensic *tour de force*. The fact of a sale is declared, rather than demonstrated by any acceptable rationale."[15]

To contrive a sale where none exists petitioners imply that the concept of a "sale" as that term is used in the Act—and presumably in this Court's decision[16]—carries some mysterious yet-to-be-articulated definition. Such an approach defies the established guidance from this Court:

> "As we have often said, 'the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses.' "[17]

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[14]Shell pet., app. p. 15a.
[15]Shell pet., app. p. 47a.
[16]See note 9 page 6 above.
[17]*Malat* v. *Riddell*, 383 U.S. 569, 571 (1966); *McNally* v. *Hill*, 293 U.S. 131 (1934); see *Old Colony RR* v. *Comm'r.*, 284 U.S. 552, 560 (1932).

And, as pointed out by the Court below:

> "This canon is given reinforcement for this term because 'sale' was *not* one of the terms for which Congress provided an express or supplemental definition in § 2 ('Definitions') of the Natural Gas Act."[18]

It is one thing to declare that the FPC is not bound by Hornbook definitions or local decisions not applicable to the Natural Gas Act. But, as Commissioner Carver insisted, this is not to say the Commission is:

> ". . . at liberty to enlarge that principle into an unrestricted license to snatch our own definitions out of the cosmos, hand-tailored to fit the case, any more than problems of consideration can be swept away by denigrating reference to established legal concepts."[19]

Elsewhere petitioners sidestep the issue by question-begging phrases. Thus Mobil argues that "Commission regulation has applied to the entire *stream* of natural gas regardless of these classifications of interests under state law."[20] But Congress told the FPC to regulate "sales", not "streams". Typically the sale of *all* of the gas—8/8ths, not just 7/8ths—is made by the lessee to the pipeline. As the Court of Appeals wrote:

> "The lease terms give the lessee all possessory interests in gas produced during the life of the lease, including full right of sale."[21]

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[18] Shell pet. app. p. 9a.
[19] Shell pet., app. p. 48a.
[20] Shell pet., app. p. 10a.
[21] Mobil pet. 3-4.

That sale of the full stream *is* regulated. And the lessee-seller is likewise regulated as a "natural gas company engaged in such sale".

In considering whether the landowner has made a "sale in interstate commerce", three questions are basic and inescapable:

1. What instrument embodies the terms of sale?
2. Who is the seller?
3. Who is the buyer?

If there were a sale by a landowner, one of two instruments would embody its terms—either the oil and gas lease between the landowner and the lessee-producer or the gas sales contract between the lessee-producer and the interstate pipeline. The contrast between the two is obvious even from a cursory reading.[22] Petitioners themselves are not in agreement as to which of the instruments constitutes the alleged "landowner's sale". And the explanation in the Commission's petition is at odds with the explanation in the Commission majority's opinion which was reversed by the Court below.

The oil company petitioners advocate landowner jurisdiction by arguing that the oil and gas lease is an interstate sale—or, more accurately, that a *part* of the oil and gas lease is an interstate sale. This was the theory of the Commission majority reversed by the Court below. Chairman White argued:

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[22]A typical example of an oil and gas lease is found at R 82 and of a gas purchase contract at R 96. "R" references are to the printed appendix filed with the Court below.

> "The royalty payment provisions of oil and gas leases constitute a sale for resale of natural gas in interstate commerce subject to regulation under the Natural Gas Act and the royalty owners are natural gas companies for purposes of the Act."[23]

Recognizing, as they must, that an oil and gas lease is *not* a sale of gas under any previously accepted understanding of the term, petitioners try to carve out a part of the lease and call it a sale. Mobil, for instance, refers to "the *part* of the lessor-lessee transaction held to be jurisdictional".[24] And Amoco insists that "The only provision of the oil and gas leases . . . before the Court is" the royalty covenant.[25]

That effort to torture a lease provision into a sale by excising one clause from the entirety of the lease not only would rewrite the lease contract by the technique of massive deletion but it would also fly in the teeth of express statutory prohibitions against ignoring other parts of an allegedly regulated sale contract. Congress has imposed Commission responsibility, not merely over the rates of natural gas companies, but over:

> ". . . the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services."[26]

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[23] Shell pet., app. p. 39a.

[24] Mobil pet. 23 — italics by Mobil.

[25] Amoco pet. 6.

[26] Natural Gas Act, § 4(c), 52 Stat. 822, 15 U.S.C. § 717c(c).

If the oil company petitioners were correct in contending that an oil and gas lease constitutes a sale of gas in interstate commerce, then the signatory landowner would be required, by Section 4(c) of the Act, to file the lease with the Commission as a rate schedule. This stretch of Commission jurisdiction would call for a deluge of hundreds of thousands of oil and gas leases. In an effort to avoid that inundation, ordering Paragraph (B) of Chairman White's opinion directed that:

> "For regulatory purposes such sales are covered by the filings of the producer-operators and payment by the producers to the royalty owners should be made as provided by the contractual provisions of each lease, except that in no event should the payment exceed the just and reasonable rates as fixed by the Commission under the Act."[27]

But the producer would have filed as a rate schedule the contract made between the producer and the pipeline company and to which the landowner is not even a party.

In the oil and gas lease—if it be the instrument of sale as those petitioners urge—the producer is the *buyer*. Ordering paragraph (B) would turn Section 4(c) of the Act upside down by using the *buyer's* rate filing to cover the *seller's* sale. The fiction of that approach is underscored by the fact that the landowner may never have agreed to accept a royalty calculated on the producer's sale price—never have agreed to

[27] Shell pet., app. p. 40a.

"sell" at the producer's rate. The Commission opinion recognized that fact by requiring payments from the producer (buyer) to the landowner (seller) to be made as provided by the "contractual provisions of each *lease*" rather than by the rate schedules under which the Commission says "such sales are covered". It is a complete contradiction to say that the landowner's "sale" is covered by the producer's filing and yet to say that the rate payable to the landowner is not the rate set out in the producer's filing. It would be equally nonsensical, however, to say that a landowner, who had contracted with the producer for a royalty calculated on a fraction of the production say at five cents per MCF, would be bound to accept royalty calculated on a four cent rate established in a producer's filing for its sale to the pipeline—for the very obvious reason that the landowner never agreed with anybody on that four cent price. In fact, that price is flatly inconsistent with the only agreement that the landowner did make.

These contradictions—besides signaling the Pandora's box of problems which the jurisdictional extension would open[25]—more basically constitute a *reductio ad absurdum* of the nonsensical pretense that a part of the lease constitutes a gas sale by the landowner and he is "therefore" somehow bound by a sale contract between the lessee and the pipeline to which he was never a party.

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[25]Cf. the observation of the Court of Appeals that ". . . if the FPC's jurisdiction over royalty owners were sustained its regulatory problems might be more complicated than it has assumed." Shell pet., app. p. 20a.

The petition of the Commission, on the other hand, seems to say that the gas purchase contract between the lessee-producer and the pipeline is the instrument of sale by the landowner. To avoid the obvious answer that the landowner cannot have made a sale by that contract since he is not even a party to it, that petition suggests a new legal fiction:

> "In entering into an oil and gas lease, a royalty owner, in effect, appoints the lessee-producer as its *agent*. Under the lease, the producer is obligated to develop the leasehold and market any gas produced therefrom."[29]

From this we suppose it is intended for the Court to infer that the landowner, as principal, has sold gas to the pipeline company under a contract made for the landowner by the lessee-producer as an authorized agent. But this reasoning defies reality in a number of significant respects.

A principal has a basic right to control the actions of his agent. Yet the landowner cannot control the sale by the lessee-producer. In the same paragraph of its petition the Commission concedes that "a royalty owner has *no* control over the incidents of such a sale" and then inexplicably criticizes the Court of Appeals for giving any determinative weight to that fact.

It makes no sense at all to treat an oil and gas lease which expressly requires royalty payments on gas production to be computed on one basis as constituting an implied authorization for the lessee to

[29]FPC pet. 9.

enter into a contract with someone else that would substitute different payments to the landowner computed on another basis. How can it be rationally argued that a principal has authorized his agent to make a contract with a third party which constitutes an amendment of the agreement between the principal and the agent?

To come back to the real world—the Burnett Trustees did not choose to go into the gas production business. Theoretically they could have done so as owners of the land—though probably not without violating applicable laws on lawful investments by trustees—but the fact is they did not. Instead they leased the land to Huber. They reserved no gas. They sold no gas. Yet from the mere existence of a rejected possibility the Commission's new argument would put the Burnett Trustees in the gas business by implication:

> "If the royalty owner had not entered into the lease, but had itself developed and sold in interstate commerce the natural gas underlying its property, it would clearly be subject to the Commission's jurisdiction. The fact that the royalty owner designates another to develop and market the gas should not operate to bar Commission jurisdiction over the retained fractional interest of the royalty owner in the sale of the gas."[30]

The implications are simply contrary to fact. The Burnett Trustees did not "designate" anyone to develop and market gas for them. They leased land to Huber so Huber could develop and market gas for

[30]FPC pet. 9-10.

Huber. That a royalty is payable with respect to a fraction of Huber's production is a far cry from a principal-agency relationship. The several analogies in the Court of Appeals opinion, we believe, are proper and pertinent.[31]

Mobil, reading far more into the decision below than is there, concludes that it "disposes of questions pending in numerous fora".[32] Lessor-lessee differences are neither new nor catastrophic. They have been before many judicial forums many times.[33] The decision below undertakes to dispose of no substantive questions. It merely holds that the judiciary, not the FPC, is the place to resolve lessor-lessee controversies.

Mobil's petition p. 26 sounds another alarm:

> "The record shows that at least one state court has already concluded that the royalty owner should be paid on the basis of 'market value' even where a payment clause provides only for payment of a share of 'proceeds'."

If some state judge has committed that error, the remedy is by appeal. To suggest that an incorrect state court decision on a question of lease construction justifies a demand by the wronged party that the United States Supreme Court rewrite a federal statute to expand the authority of an administrative agency is really too much.

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[31]Shell pet., app. p. 162.

[32]Mobil pet. 21.

[33]See, e.g., *Phillips Petroleum Company v. Bynum*, 155 F.2d 196 (5th Cir. 1946); *Union Producing Co. v. Pardue*, 117 F.2d 225 (5th Cir. 1941); *Chicago Corporation v. Wall*, 156 Tex. 217, 293 S.W.2d 844 (1956); *Arkansas Natural Gas Co. v. Sartor*, 78 F.2d 924 (5th Cir. 1935), cert. den. 296 U.S. 656.

If there is to be any order in our jurisprudence, the determination of the Court of Appeals that a landowner who grants an oil and gas lease on a naked piece of ground is not a natural gas company making a sale of gas in interstate commerce must be correct. And certiorari is not needed to say so. Commissioner Carver aptly described Chairman White's reasoning to the contrary as "a bootstrap conclusion [which] taxes credulity to the breaking point."[34]

All this country needs to bring complete chaos to gas regulation is a judicial extension of FPC jurisdiction over thousands of oil and gas leases and the landowners who have rights and obligations under those leases.

The Court of Appeals properly held that Congress *intended* no such thing. Section 1 of the Act expressly refers to the reports of the Federal Trade Commission and declares that "the *business* of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest."[35] A mere landowner of an Oklahoma farm or a Texas ranch is hardly in that business. As this Court has taught, the

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[34]Shell pet., app. p. 46a. The issue has received scholarly scrutiny in two separate law review commentaries on the Fifth Circuit's decision in *J. M. Huber Corp. v. Denman, supra*. Both writers reach the same conclusion. The article in 42 New York University Law Review 552, 559 (1967) analyzes the question and expresses this view as to the proper interpretation of the statute:

> "Thus Huber, in asking the FPC to regulate the royalty payable to the lessor, seeks protection for an interest not covered by the act. Whether the FPC should control the terms on which gas rights may be leased is for Congress to decide."

The editor in 45 *Texas Law Review* 765, 771 (1967) reaches the same conclusion. We commend to the Court both of those fine law reviews.

[35]52 Stat. 821, 15 U.S.C. § 717(a).

Federal Trade Commission reports—on which "the 1938 Act was based"[36]—were concerned with anything but the thousands of landowners in all the gas producing states:

> "Moreover, the investigations of the Federal Trade Commission had disclosed that the majority of the pipe-line mileage in the country used to transport natural gas, together with an increasing percentage of the natural gas supply for pipeline transportation, had been acquired by a *handful of holding companies.* State commissions, independent producers, and communities having or seeking the service were growing quite helpless against these combinations. These were the types of problems with which those participating in the hearings were preoccupied. *Congress addressed itself to those specific evils.*"[37]

Finally, Shell contends that even though the landowner makes no *sale*, the courts should impose FPC jurisdiction over the oil and gas lease on an "additional" ground. In essence the argument is that the FPC *should* have jurisdiction over gas royalties because they constitute costs which *affect* interstate sales by regulated companies. This Court is thus asked to repudiate its prior tripartite analysis[38] and add a fourth jurisdictional category.

From the premise that ". . . the price to be paid for [sic] royalty interests has a direct and substantial effect on the price paid by the ultimate consum-

[36]*FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 9 (1961).
[37]*FPC v. Hope Natural Gas Company*, 320 U.S. 591, 610 (1944).
[38]*Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 516 (1947) – quoted above at p. 6.

er,"[39] Shell would conclude that landowners are natural gas companies under the Act. But the Act says no such thing. A royalty payment to those upon whose land wells are drilled is only one of a myriad of costs which have a direct and substantial effect on the price paid by the ultimate consumer. Congress, however, directed the FPC to regulate the *sale* of gas and the *seller*—not the *costs* incurred by the seller nor the persons to whom such costs are paid.

With respect to Shell's "necessity" argument the Court of Appeals wrote:

> "If an interpretative ruling *stretching* the Act as written to cover leases by landowners is to be countenanced on the score of necessity, and we do *not* say this will be possible, the underlying record must be more comprehensive and profound—broader and deeper, as it were—than the findings and analysis presented on this record."[40]

From this foundation, petitioners argue that the Court of Appeals should have remanded for further administrative hearings. Not so. Any thought of stretching the Act because of someone's idea of necessity is more properly directed to Congress. This Court has said it well:

> ". . . the determinative question is not what the Board thinks it *should* do but what Congress has said it *can* do."[41]

The Court of Appeals for the District of Columbia

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[39] Shell pet. 8.
[40] Shell pet., app. p. 18a.
[41] *Civil Aeronautics Board* v. *Delta Airlines*, 367 U.S. 316, 322 (1961).

Circuit is not noted for restrictive interpretations on questions of administrative agency jurisdiction. Its conclusions in this case are eminently correct.

There Is No Conflict of Decisions

The decision of the Court of Appeals is completely consistent with prior law. As mentioned earlier, this Court has held that the Act grants jurisdiction over interstate *transportation*, interstate *sales* and *companies* engaged therein and nothing more.[42] The Court below followed that guidance.

This Court has also held that a landowner who receives royalties under an oil and gas lease is not a seller of production from the lease. In considering whether such a royalty owner makes a "sale" under a taxing statute applicable to sales, Justice Stone differentiated between royalty receipts and sale proceeds:

> "[T]he statute speaks of a 'sale' and these leases would not generally be described as a 'sale' of the mineral content of the soil, using the term *either* in its technical sense or as it is commonly understood. **Nor would the payments made by lessee to lessor generally be denominated the purchase price of the oil and gas.** By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil and gas for a prescribed period; he may explore, drill, and produce oil and gas if found."[43]

The decision below likewise holds that a landowner

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[42] *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 516 (1947) – quoted at p. 6 above.

[43] *Burnet v. Harmel*, 287 U.S. 103, 107 (1932)

by receiving royalties under an oil and gas lease, does not thereby make a sale of gas. This is true, using the term in its commony understood sense—and also in its technical legal sense."

The argument that the FPC has jurisdiction over payments by lessee-producers to royalty owners was rejected by the Texas courts in a 1957 action by a royalty owner against his lessee over the amount of royalty payable:

> "Respecting the FPC rates, the regulatory body simply made no effort to and did not fix a rate as between LeCuno and these litigants . . . The FPC wisely made no effort to come between the producer and its royalty owners and left the matter of costs and charges as between them to their own arrangement. . . . The regulatory authority of FPC is not involved in this suit. Nor can it be said that that agency has exclusive jurisdiction of the controversy between these litigants or even that there is *any* controversy between the litigants that the FPC in the exercise of its *lawful* authority might determine."[45]

And this Court *refused certiorari* to review that deter-

[44] Citing the Fifth Circuit opinion in *J. M. Huber Corp.* v. *Denman*, 367 F.2d at 113-114, the Court below noted:

> "[The lessors make] the very simple, yet profound, contention that there can be no 'sale' of gas by royalty owners since they have no gas to sell. And this seems to be true as a matter of oil and gas law, whether based on the ownership-in-place concept followed by Texas and others or on non-ownership theories of other jurisdictions. For *all agree* that as the gas leaves the well-mouth, the entire ownership of the gas is in the lessee, none being reserved in the lessor."

Shell pet., app. p. 10a.

[45] *LeCuno Oil Company* v. *Smith*, 306 S.W.2d 190, 193-4 (C.C.A. Tex. 1957); writ den. n.r.e. (Texas Supreme Court).

mination.[46] The decision below is also consistent with that precedent.

Petitioners, on the other hand, urge a holding which would necessarily conflict with this Court's explanation in *Mobile* of the scheme of the Natural Gas Act.

> "The basic power of the Commission . . . is simply the power to review rates and contracts made in the first instance by natural gas companies . . ."[47]

If, as petitioners contend, landowners were natural gas companies, then the royalties payable would be those established initially by agreement with the landowners. Instead the oil company petitioners would *impose* upon the landowners rates established by agreement between the oil companies and the pipeline. Mobil, for example, confesses that it would insist that royalty payments be limited to a share of the lessee's proceeds no matter what the lease said to the contrary.[48]

The Commission's petition suggests that the Commission has given a nod to the *Mobile* principle by holding "that royalty rates for interstate sales are to be governed by either the rate provided for in the lease or the just and reasonable rate as determined by the Commission, whichever is lower."[49] This would impose an area rate on landowners as a result of area proceedings to which landowners were never made

[46] Ibid., 356 U.S. 974 (1958).
[47] *United Gas Pipe Line Co. v. Mobile Gas Service Corporation*, 350 U.S. 332, 341 (1956).
[48] Mobil pet. 21-23.
[49] FPC pet. 7.

parties.[50] Then the Commission's petition, in the same paragraph, rejects the *Mobile* principle that the landowner (if it were a natural gas company) should initially make the "rate". Specifically it argues:

> "Where the just and reasonable rate has not yet been determined by the Commission, royalties are to be governed by the *producer's* effective rates, subject to adjustment upon establishment of the just and reasonable rate."

The decision below, by rejecting the pretense of a "sale" by a landowner who in reality makes no sale, remains consistent with *Mobile*.

Also the negation of FPC jurisdiction over royalties payable under oil and gas leases is consistent with the landmark *Panhandle Eastern* doctrine. Commissioner Carver put the proposition well:

> "In point of time and the legal and economic interests created, primary lease execution is clearly antecedent to any facet of 'production and gathering.' The lease constitutes the very essence of the relationship between landowner and lessee-producer. If the language in *F.P.C. v. Panhandle Eastern Pipeline Co.* (1949) 337 U.S. 498, 505, holding 'leases an essential part of production' is not controlling here, it is difficult to conceive of a case where it would be."[51]

Petitioners assert that the decision below is in conflict with three decisions of this Court in *Phillips*[52]

[50] Cf. Court of Appeals analysis, Shell pet., app. p. 20a.

[51] Shell pet., app. p. 51a.

[52] *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

Rayne,[33] *Bastian Bay*,[34] and with the "filed rate" doctrine.[35] The court below—in our view correctly—saw no such conflict.

Phillips involved only the question of FPC jurisdiction over an admitted *sale* by a lessee-producer. It has no bearing on the efforts of petitioners to extend that jurisdiction to landowners who receive royalties under oil and gas leases but who make no sale.

Rayne and *Bastian Bay* were companion cases. In fact *Bastian Bay* was summarily reversed in a per curiam memorandum decision which simply cited *Rayne*.[36] The Court below carefully analyzed these decisions and found no conflict. In *Bastian Bay* and *Rayne*, as pointed out by the Court of Appeals, this Court was confronted with "a transaction that was in *form* a lease of reserves but in economic impact the equivalent of 'conventional sales of natural gas' ".[37] Distinguishing that situation from ours the Court of Appeals accurately held:

"When we come to an ordinary lease by the

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[33]*United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965).

[34]*Federal Power Commission v. Pan American Petroleum Corp.*, 381 U.S. 762 (1965).

[35]*Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951).

[36]Interestingly Amoco, of all people, refers to the "importance of this case to natural gas consumers and the natural gas industry" as similar to *Phillips*, *Bastian Bay*, and *Rayne* (Amoco pet. 9) and describes *Bastian Bay* and *Rayne* as examples of "parties seeking to avoid rate regulation". (Amoco pet. 14). They should know whether *Bastian Bay* and *Rayne* were avoidance cases for Amoco, under its then name of Pan American Petroleum Corporation, *was* the petitioner in *Bastian Bay*. There however, contrary to what it now says, Amoco assured the court that it was *not* using a subterfuge to avoid rate regulation.

[37]Shell pet., app. 13a.

> landowner to the producer there is neither a 'customary' sale in interstate commerce nor its equivalent in economic effect. Such a lease is a transaction that is itself customary and conventional, but one that precedes the 'conventional' sales in interstate commerce with which Congress was concerned, indeed even precedes the 'production and gathering' which § 1(b) visualized as preceding the sale in interstate commerce over which jurisdiction was being established."[58]

Amoco goes full tilt. In an effort to bring this case within those decisions, they accuse the Court below of permitting landowners "to utilize technical concepts of local law of sales to avoid rate regulation by simply *casting the transaction* in such a form"[59] as an ordinary oil and gas lease. Again they argue that the Court below permits landowners to employ concepts of local law "in *formulating* gas royalty clauses that exempt payment of royalty interests in gas sold from Commission rate regulation."[60] These charges assume, contrary to fact, that landowners have designed oil and gas leases to circumvent intended regulation under the Act. Nothing could be further from the truth. Most oil and gas lease forms have been designed by oil companies themselves—not by landowners—and in large part they antedate even the passage of the Natural Gas Act. There is nothing in the record of this case or elsewhere to suggest that these lease forms have been prepared as an escape mechanism.

Lastly Cities Services searches for a conflict with

[58]Shell pet., app. p. 14a.
[59]Amoco pet. 8.
[60]Amoco pet. 13.

the "filed rate" doctrine announced by this Court in 1951[61] and they argue that "there can be no retroactive changes of rate made effective without suspension under Section 4 of the Natural Gas Act."[62] This begs the question. The "filed rate" doctrine precludes changes, except by following the statutory procedure, in a rate previously filed with the Federal Power Commission by a natural gas company covering its sales. There is nothing in that doctrine remotely prohibiting the natural gas company from making royalty payments in compliance with its leases. If, as petitioners would have it, landowners were to be regarded as natural gas companies, then as a beginning point they would surely be entitled to receive the "rates" called for by their oil and gas leases unless and until the Commission had held a hearing finding such "rates" unlawful and prescribing new ones.[63]

Petitioners seek by administrative brute force to convert all gas lease royalty clauses into "proceeds" clauses without a hearing—with disregard to what the landowners and their lessees may have agreed to —and without filings or hearings before the Commis-

[61] *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951).

[62] Cities Service pet. 14-15.

[63] *United Gas Pipe Line Company v. Mobile Gas Service Corporation*, 350 U.S. 332 (1956). See also the holding in *Phillips Petroleum Company v. Federal Power Commission*, 258 F.2d 906, 914-5 (10th Cir., 1958):

> "It seems clear to us, therefore, that the price which Phillips was entitled to receive and Panhandle was obligated to pay, by the terms of the contract, on June 7, 1954, was the rate fixed and prescribed by the rate schedule and that such rate was *not* the price reflected by the billing statement or actually *being paid by the buyer* and received by the producer on June 7, 1954."

sion.[64] Mobil would excuse such strong-arming with the specious comment that "The 'royalty' owner bears no costs and does not engage in exploration and development."[65] This comment is consistent with the lack of a sale by the royalty owner. It is in conflict with the argument in the Commission's petition that the royalty owner has designated the lessee as an agent to explore and develop gas for him. See pp. 17-19 supra.

Besides, where would the oil companies of America be without access to the land which the landowner's oil and gas lease alone affords them? Where would this exploration and development be conducted if oil and gas leases were not available? By what process of reasoning does Mobil Oil Corporation look upon its payment of royalty to the landowner as some sort of a gratuity?

At page 26 of its petition Mobil foresees (with really no basis) massive increases in royalty payments unless the FPC immediately extends its jurisdiction to oil and gas leases and this, they imply, is contrary to the public interest. What a contrast with the position of Mobil a few short years ago before the Supreme Court of Texas.[66] In that instance Mobil itself had become the owner of some mineral interests. Gas royalties were being paid by Pan American (now

[64]**One wonders how this technique would apply to the thousands of leases to pipeline companies. In those situations the *only* sale of gas is by the pipeline company under tariffs which are many times *higher* than the field market price.**

[65]Mobil pet. 25.

[66]*Southland Royalty Company v. Pan American Petroleum Corporation*, 378 S.W.2d 50 (Tex.Sup.Ct. 1964).

Amoco) at a rate of $100 per well. Mobil thought nothing of suing to increase those payments to a royalty share of almost a million dollars worth of gas production.[67] And—most significantly—neither Mobil nor Amoco turned to the FPC in that royalty dispute although the gas was being sold by the producer in interstate commerce. Yet they now both tell this Court that the FPC has had jurisdiction over such matters for eighteen years.

The Case Involves No Matter of Serious National Concern

The controversies before this Court are private disputes between a very few major oil companies[68] and a relatively small number of individual landowners. Notwithstanding the FPC's open invitation for participation by anyone interested in the hearings below, the case has essentially been ignored by all interstate pipelines, all state regulatory agencies, virtually all distribution companies, and the vast majority of producers. That would not have been the case if significant issues of national import had been at stake.

Understandably petitioners strain to find grave consequences in their effort to provoke action by this Court. Shell speaks of national supply shortages:

> "The present crisis in the nation's supply of natural gas has received the recognition of the

[67] *Southland Royalty Co. v. Pan American Petroleum Corp.*, 354 S.W.2d 184, 190 (Tex. C.C.A. 1962).

[68] Mobil, Amoco, and Huber supported by intervenors, Shell and Cities Service.

> Courts and is receiving the continuing attention of the Federal Power Commission."[69]

The tacit implication is that the solution to gas shortages is an expanded FPC jurisdiction. Most knowledgeable parties (including Shell in other forums) feel just the opposite. To subject landowners to regulation of a federal administrative agency simply because lessees of their lands produce and sell gas in interstate commerce would hardly be calculated to increase the available leaseholds without which drilling and production are impossible. Common sense compels the conclusion that many landowners would refuse to lease their lands or lease it upon condition that gas sales be made only in intrastate commerce.

Mobil utilizes the technique of large numbers by alluding to the fact that royalty is paid with respect to "13,000,000 million cubic feet sold each year" subject to FPC regulation.[70] The point is that *all* of that "13,000,000 million cubic feet" is already subject to FPC control as it is sold by the producer in interstate commerce. Only four or five major oil companies think regulation must be expanded behind the sale and over the seller's royalty costs in order to remain effective.

With mounting momentum Mobil resorts to coercive threats to have all the area rate proceedings nullified unless this Court agrees to their petitions for certiorari:

> "A more immediate result will be that if the opinion below should become final, petitioners

[69]Shell pet. 11.
[70]Mobil pet. 16.

> must seek immediate remand to the Commission of four 'area rate' cases now on review and by which the Commission had fixed rates for more than 60 per cent of the natural gas moving in interstate commerce."[71]

We question whether Mobil really would seek any such remand but, in any event, Mobil seeks many things which Mobil does not get. Amoco raises similar specters:

> "Even so, the administrative burden of processing rate schedule filings by royalty interest owners that may be required would be insignificant when compared to the burden of (1) reopening past and pending area rate proceedings, (2) revising the area rate method of regulation, and (3) intervening in state court suits brought by royalty owners which would be required if the opinion of the Court below is allowed to stand."[72]

Not even Chairman White, in writing his opinion in support of jurisdiction, saw any consequences even remotely resembling those described by Mobil and Amoco.

The Commission's petition says, "unless overturned, the decision will significantly inhibit the Commission from effectively regulating the rates at which such gas is sold."[73] There is no justification for that fear. And if the FPC really needs expanded jurisdiction to do its job, Congress is the proper body to grant such enlargement. Actually the Commission has regulated

[71]Mobil pet. 20.
[72]Amoco pet. 16.
[73]FPC pet. 8.

pipeline rates since 1938 and producer rates since 1954 without experiencing the slightest difficulty from lack of jurisdiction over landowner royalties.

We suspect that this is not the first time this Court has seen consequences of decisions below grossly exaggerated. And we doubt that anything we could say further would make those exaggerations more evident than they already are.

CONCLUSION

The Court of Appeals issued a tightly reasoned, highly professional opinion. It properly disposes of a rather clear cut legal issue. Certiorari to reconsider that issue in the highest court of the land is unnecessary and should be denied.

Respectfully submitted,

CECIL E. MUNN
1800 First National Building
Fort Worth, Texas 76102
Counsel for Respondents
William Harvey Denman, et al

Of Counsel:
Cantey, Hanger, Gooch, Cravens & Munn

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No. 71-1326

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

FEDERAL POWER COMMISSION,

v.

MOBIL OIL CORPORATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF RESPONDENT IN OPPOSITION

H. H. HILLYER, JR.
1122 Whitney Building,
New Orleans, La. 70130
Counsel for Respondent,
The Land and Royalty
Owners of Louisiana

MILLING, SAAL, BENSON,
WOODWARD & HILLYER
1122 Whitney Building,
New Orleans, La. 70130
OF COUNSEL

J. G. HAUSER, INC., "LEGAL PRINTERS", 100-A JEFFERSON HWY., N. O., LA. 70121

SUBJECT INDEX

	PAGE
OPINIONS BELOW	2
JURISDICTION	2
QUESTION PRESENTED	2
ADDITIONAL QUESTIONS PRESENTED	2
STATUTE INVOLVED	3
STATEMENT	3
REASONS FOR DENYING THE WRIT OF CERTIORARI	5
CONCLUSION	10

INDEX OF AUTHORITIES

CASES:

Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 9

Burnett v. Harmel, 287 U.S. 103 6

California v. Lo-Vaca Gathering Company, 379 U.S. 366 6

Civil Aeronautics Board v. Delta Airlines, 367 U.S. 316 8

National Labor Relations Board v. Steinberg, 182 F. (2d) 850 (C.A. 5th, 1950) 8

Permian Basin Area Rate Case, 390 U.S. 747 9

United States Improvement Co. v. Continental Oil Co., 381 U.S. 392 6

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF RESPONDENT IN OPPOSITION

The Land and Royalty Owners of Louisiana ("Larola") opposes the petition of the Solicitor General ("Petition"), acting on behalf of the Federal Power Commission, for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case. While other petitions for certiorari have been filed by private parties, and although Larola opposes such petitions and does not waive

its grounds therefor, it has chosen to limit its Brief in Opposition to the Petition in this case.[1]

OPINIONS BELOW

The opinions below are correctly stated by the Petition.

JURISDICTION

The jurisdiction is correctly stated by the Petition.

QUESTION PRESENTED

1. Whether the lessor under an oil and gas lease makes a "sale in interstate commerce of natural gas for resale"[2] and thus becomes a "natural gas company"[3] subject to regulation by the Federal Power Commission as the result of receiving payments for gas royalties provided for in said oil and gas lease when the original lease is not a "sale" of gas, the lessor-royalty owner performs no other act which could evidence a "sale" of gas, and, in law and in fact, owns no gas to sell and has no control over its disposition?

ADDITIONAL QUESTIONS PRESENTED

Although not reached by the court of appeals, which correctly disposed of the case solely on its decision of the first

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1 The other pending petitions for certiorari are: *Mobil Oil Corporation v. Carl F. Matzen, et al.*, No. 71-1169; *Amoco Production Company v. Leland C. Waechter, et al.*, No. 71-1179; *Cities Service Oil Co. v. Carl F. Matzen, et al.*, No. 71-1188; *Shell Oil Company v. Carl F. Matzen, et al.*, No. 71-1191.

2 15 U.S.C. §717(b).

3 15 U.S.C. § 717(a).

question, there are additional questions involved, as follows:

2. Whether the Federal Power Commission may lawfully decide that such a lessor makes a "sale . . . of natural gas for resale" and thus becomes a "natural gas company" subject to regulation without

(a) determining the meaning of the word "sale" as used in the Act,

(b) determining what factual circumstances constitute a "sale" of gas by the lessor-royalty owner,

(c) determining what factual circumstances are present in this record to evidence that a "sale" of gas is made by the lessor-royalty owner,

(d) making a lucid and careful analysis of the facts on which its conclusion is based, and

(e) giving an explicit rationale of the conclusion reached?

3. Whether there is any substantial evidence in this record to support the Federal Power Commission's finding that such a lessor-royalty owner makes a "sale" of natural gas for resale?

STATUTE INVOLVED

The Petition correctly states the statute involved.

STATEMENT

The "Statement" of the Petition seems to be focused upon the history of the private litigation between lessors and lessees which gave rise to the instant proceeding. Larola is *not* interested in the outcome of the private litigation in which the Federal Power Commission became to the producer-lessees a

possible avenue of escape from lease obligations. Larola is profoundly interested in denying the right or necessity of the Commission to exercise jurisdiction over the royalty provisions of private contracts between lessor and lessee affecting private lands.

The record herein is uncontradicted that in the normal lease situation a landowner, prior to the time when natural gas is or is not known to exist under his premises, grants to a lessee a mineral lease which gives the lessee the exclusive right to go upon the leased premises, explore and develop the property, and, if gas is discovered, take into the lessee's exclusive possession 100% of such gas, sell it as the lessee chooses, for what price the lessee chooses, and for what terms the lessee chooses. The mineral lessor has no legal, factual or economic control or right of control over any of the actions of the lessee in producing and marketing the gas.

The mineral lease is usually granted in consideration of the payment of a cash bonus, of payments of delay rentals for the privilege of deferring drilling, and of payments by the lessee to the lessor of royalties on all gas produced. Gas royalties are calculatted on a fraction (usually 1/8th) of either the amounts received by the lessee or of the market value of such fraction. Traditionally sales of gas to pipelines by lessees have been based on a stated price per Mcf. This means that the lessor's royalty payments are usually also calculated on volumes produced and are paid either on the basis of the amounts received by the lessee or on the market value in the field.

Royalty costs are only a fraction of a producer's total costs. The Federal Power Commission has not undertaken to regulate any of the producer's other costs. There is no substantial evidence in the record of this proceeding to establish that the failure to regulate royalty payments will materially

adversely affect either the consumer, the pipeline purchaser or the producing industry generally. There is not even any substantial evidence that the giant oil companies here involved would be materially adversely affected in their nationwide operations. There is no substantial evidence in this record that the current or future area rates for producers will require upward adjustment as the result of the unregulated royalty payments.

These are the facts upon which the jurisdictional question turns.

REASONS FOR DENYING THE WRIT OF CERTIORARI

The decision below is clearly correct in holding that, in the ordinary lease situation, the recipient of royalty payments makes no sale of natural gas for resale in interstate commerce. He owns no gas, has neither legal, factual nor economic control over its production, use or disposition and does nothing which could possibly be construed as a "sale". The decision below does not conflict in principle with prior decisions of this Court. There is, in fact, no "regulatory gap". The interest of the consumer is already protected; the only interests that would be protected here are those of private litigants who have made bargains which they do not wish to fulfill.

1. The court of appeals quite properly found[4] that, for jurisdiction to attach under the Natural Gas Act, a royalty owner must be held to be engaged in a sale in interstate commerce of natural gas for resale. Whether landowners or other royalty owners are engaged in the sale of natural gas in

4 Mobil App. 22-25. "Mobil App." references are to the Appendices to Mobil Oil Corporation's petition for certiorari in No. 71-1169.

interstate commerce within the meaning of Section 1(b) of the Act must be determined by reference to the intention of Congress. The court, following the *Rayne Field* case *(United States Improvement Co. v. Continental Oil Co.*, 381 U. S. 392) stated that Congress' intention cannot be conclusively determined by reference to classifications under state law. But it found that, as a point of departure, it is necessary to begin with the presumption that Congress had in mind the ordinary, usual and natural sense of the word "sale". The court found that generally the recipient of royalties is not considered, either in common parlance or in state law decisions, to be engaged in a "sale". This was the same concept that was expressed in the opinion of this Court in *Burnett v. Harmel*, 287 U. S. 103. Relying upon the normal and usual meaning of the word "sale" as it existed when the Natural Gas Act was passed, the court found that the factual incidents to the receipt of royalties by a landowner did not involve a "sale" in its usual and normal sense and that, therefore, Congress did not intend to include within the Commission's jurisdiction the regulation of royalty payments.

This was as far as the court below needed to go, and it was completely correct under the prior decisions of this Court which the court of appeal cited.

2. The Petition (p. 9) concludes that the principles announced in the *Rayne Field* case, *supra*, and in the case of *California v. Lo-Vaca Gathering Company*, 379 U. S. 366, require that the "economic realities and physical facts" determine the extent of jurisdiction under the Natural Gas Act – presumably in disregard of the words of the Act. We think it too clear for extended discussion that, if royalty payments were not included within the word "sale" under the Act and jurisdiction to regulate them not conferred, it makes no difference what the so-called "economic realities and physical

facts" are. The opinion of the court of appeals quite clearly demonstrates this.[5]

The Petition seems to infer that the court of appeals departed from the decisions of this Court and governed its decision on technical concepts of local law. Nothing could be further from the fact. The court of appeals considered these same contentions most carefully and disposed of them. It would be a work of supererogation here to attempt to embroider upon the concise and perceptive exposition of the different principles involved given by the court below. We commend this exposition[6] to this Court's attention.

Be all that as it may, however, the "economic realities and physical facts" here do not support the existence of a sale. The royalty recipient has no legal or factual right to take the gas, to use the gas, to dispose of the gas, to control its disposition, to determine to whom the gas is to be sold by the lessee, nor to determine the price per Mcf the lessee is to receive for the gas. The royalty recipient thus has none of the aspects of economic control. If the royalty recipient's lease contract (as did some old leases) provided that the lessor was to be paid $100.00 per well per year for all gas produced from the leased premises, no one could contend that a "sale" existed. The thrust of the Petition's argument appears to be that because the lease provisions require that the royalty payments be calculated on a fraction of the volumes produced and disposed of *by the lessee*, this *ipso facto* results in a sale of *gas by the royalty* recipient. In other words, the distinction to be drawn from the Petition seems to be that calculation on fractions and volumes is the sole necessary ingredient to a "sale". This flies in the face of all law and of the economic facts here.

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5 Mobil App. 25-31.

6 Mobil App. 25-29.

3. The Petition (p. 9) contends that the lessor, by entering into a mineral lease, "in effect" appoints the lessee as its agent to market any gas produced from the lease. It is difficult to comprehend how the lessor could appoint the lessee as the lessor's agent to sell the *lessee's own gas.* Beyond that, the leases on their face do not purport to create any such agency. In order for the relationship to exist in derogation of the private contract there must be some exercise of actual control by the principal over the actions of the agent – so-called "economic control" does not suffice.[7] Here, the facts in the record clearly show, as has been above demonstrated, that there exists neither actual nor economic control by the lessor over the lessee's marketing of 100% of the gas produced. There is no need to decide a question of law; under any tenable theory of law the facts show that no such "agency" exists.

4. The Petition argues (pp. 11-12) that a regulatory gap exists if royalty recipients are not regulated; that Congress intended no regulatory gap to exist; and that effective regulation requires that royalty payments be regulated. The short answer to this argument is that if Congress did not in the Natural Gas Act include royalty recipients within the definition of "natural gas companies", it makes no difference whether a regulatory gap exists or not. As the court below explained,[8] the existence of a need for regulation cannot excuse an agency's exercise of a power which was not granted to it. None of the decisions of this Court had held to the contrary.

Moreover, the Solicitor General is misinformed as to the existence of a regulatory gap. This Court has held that the

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7 *Cf. National Labor Relations Board v. Steinberg,* 182 F. (2d) 850 (C.A. 5th, 1950).

8 Mobil App. 30. *Cf. Civil Aeronautics Board v. Delta Airlines,* 367 U.S. 316.

principal purpose of the Natural Gas Act was the protection of the consumers. *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U. S. 378. The consumers are now being protected by the Commission's area price regulation of producers. The Commission's jurisdiction of the producer's price, as Commissioner O'Connor pointed out,[9] is sufficient to protect the consumer against royalty payments at any level. Under the present method of area rate regulation[10] an independent producer is not entitled to any increase in area rates for past payments of "excessive" royalties (which have already been taken into account in producer costs). Nor would the independent producer be entitled to increases in rates for future production because of the method of calculating royalty costs for new gas well gas. As expressed in Opinion No. 598 of the Federal Power Commission, issued July 16, 1971 (46 F.P.C.), at pages 53 through 56, a nationwide royalty cost in cents per Mcf is determined, which figure is derivative in the sense that the ultimate rate must first be determined and then a percentage applied. This percentage relates to the royalty fraction and not to the amount per Mcf paid as royalty by the individual producer to those entitled to royalties under the lease which he holds. Thus, when the Petition states (p. 12) "that the owners would in many instances receive compensation in excess of the royalty component allowed in the area rates determined by the Commission", the Petition is wholly in error for there is no "compensation" established by the royalty component of the area rate costing concept.

The consumers are being protected. There is no more need to regulate royalty payments than there is to regulate geophysical costs, drilling rig costs, drill pipe and casing costs,

9 Mobil App. 79 (dissent).

10 This Court has approved this method in the *Permian Basin Area Rate Case*, 390 U.S. 747.

well equipment costs, drilling crews' wages, executive salaries and overhead, or any of the other costs that a producer must incur in prospecting for and producing the gas that flows into commerce. Nor is there any need to protect the producers from the consequences of contracts voluntarily entered into, even if the Federal Power Commission enjoyed such power. The producers are well able to protect themselves in the lease contracts. In short, there is no public interest requiring the exercise of this Court's certiorari jurisdiction.

5. Because the lower court did not reach the questions raised below by Larola as to items 2 and 3 listed under "Additional Questions Presented", *supra*, pp. 2-3, and in the interest of brevity, no argument as to these questions will be made in this brief. However, the Court's attention is respectfully directed to Larola's claim that, even had jurisdiction existed, the Commission's errors would have required reversal.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

May 15, 1972

Respectfully submitted,

H. H. HILLYER, JR.
1122 Whitney Bldg.,
New Orleans, La. 70130
Counsel for Respondent, The Land and Royalty Owners of Louisiana

MILLING, SAAL, BENSON
WOODWARD & HILLYER

OF COUNSEL

No. 71-1326

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

FEDERAL POWER COMMISSION,
Petitioner,
v.
MOBIL OIL CORPORATION, ET AL.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

PETITION FOR REHEARING

ROBERT D. HAWORTH
Mobil Oil Corporation
P. O. Box 1774
Houston, Texas 77001

DONALD G. CANUTESON
Mobil Oil Corporation
P. O. Box 900
Dallas, Texas 75221

CARROLL L. GILLIAM
PHILIP R. EHRENKRANZ
1730 M Street, N. W.
Washington, D. C. 20036

Counsel for Respondent Mobil Oil Corporation

Of Counsel:

GROVE, JASKIEWICZ AND GILLIAM
1730 M Street, N. W.
Washington, D. C. 20036

June 30, 1972

WILSON - EPES PRINTING CO., INC. - RE 7-6002 - WASHINGTON, D. C. 20001

IN THE

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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PETITION FOR REHEARING

Mobil Oil Corporation (Mobil), a respondent herein, respectfully petitions this Court for rehearing upon the order entered on June 7, 1972,[1] denying the petition for writ of certiorari filed on behalf of the Federal Power Commission, and moves this Court for an order (1) va-

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[1] Mr. Justice Douglas was of the opinion that certiorari should be granted; Mr. Justice Stewart and Mr. Justice Powell took no part in the consideration or decision of the petition. The same order was entered in companion cases: Mobil Oil Corporation v. Matzen, *et al.*, No. 71-1169; Amoco Production Co. v. Waechter, *et al.*, No. 71-1179; Cities Service Oil Co. v. Matzen, *et al.*, No. 71-1188; and Shell Oil Co. v. Matzen, *et al.*, No. 71-1191.

cating the order of June 7, 1972, and (2) granting the petition.

By memorandum filed in this case, Mobil had urged that the petition on behalf of the Federal Power Commission be granted. Mobil cited its own pending petition in No. 71-1169 seeking certiorari as to the same judgment and opinion below.

On June 30, 1972, Mobil filed a Petition for Rehearing upon denial of the petition in No. 71-1169. For the reasons stated in that petition, Mobil also seeks rehearing in the instant case and urges that the petition on behalf of the Federal Power Commission be granted.

CONCLUSION

For the foregoing reasons, as well as those set forth in in the petition for writ of certiorari on behalf of the Federal Power Commission, Mobil prays that this Court grant rehearing of the order of denial, vacate that order, grant the petition, and review the judgment and opinion below.

Respectfully submitted,

ROBERT D. HAWORTH
Mobil Oil Corporation
P. O. Box 1774
Houston, Texas 77001

DONALD G. CANUTESON
Mobil Oil Corporation
P. O. Box 900
Dallas, Texas 75221

CARROLL L. GILLIAM
PHILIP R. EHRENKRANZ
1730 M Street, N. W.
Washington, D. C. 20036

Counsel for Respondent
Mobil Oil Corporation

Of Counsel:

GROVE, JASKIEWICZ AND GILLIAM
1730 M Street, N. W.
Washington, D. C. 20036

June 30, 1972

CERTIFICATE OF COUNSEL

As counsel for the respondent, Mobil Oil Corporation, I hereby certify that this petition for rehearing is presented in good faith and not for delay and is restricted to the grounds specified in Rule 58(2).

/s/ _____

CARROLL L. GILLIAM
Counsel for Respondent
Mobil Oil Corporation